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Supreme Court, U. S.
FILED
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MICHAEL RODAK, JR., CLERK

80-398

NO. _____

in the

Supreme Court
of the
United States

OCTOBER TERM, 1980

PETER PIAMBINO, et al.,
Petitioners,

vs.

WILLIAM E. BAILEY, et al.
and DAVID SYLVA,
Respondents

Petition for a Writ of Certiorari to The United States Court of Appeals for the Fifth Circuit

APPENDIX

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September 3, 1980

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APPENDIX A

United States Court of Appeals

FIFTH CIRCUIT

OFFICE OF THE CLERK

June 5, 1980

Gilbert F. Ganucheau
Clerk

TEL 504-589-6514
600 CAMP STREET
NEW ORLEANS, LA. 70130

TO ALL PARTIES LISTED BELOW:

NO. 76-3495, 77-2045 — *Peter Piambino, et al v. Wm. E. Bailey, et al*

Dear Counsel:

This is to advise that an order has this day been entered denying the petition( ) for rehearing, and no member of the panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 10) the petition( ) for rehearing en banc has also been denied.

See Rule 41, Federal Rules of Appellate Procedure for issuance and stay of the mandate.

Very truly yours,
GILBERT E. GANUCHEAU,
Clerk
By H. E. Adams, Jr.
Deputy Clerk

cc: Mr. J. Russell Pitto
Mr. Robert W. Humphreys
Mr. Stephen T. Knudsen
Mr. Marc M. Watson
Mr. Jerome M. Rosenblum
Mr. Edward L. Peck
Mr. Carl H. Hoffman
Mr. James H. Joseph
Mr. David Ferber
Mr. Ralph C. Ferrara
Mr. S. Lee Terry, Jr.
Mr. William A. Dietch
Ms. Evelyn Langlieb Greer
Mr. Michael R. Botwin
Mr. William C. Wolford

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF FLORIDA
MIAMI DIVISION

IN RE BESTLINE PRODUCTS
SECURITIES AND ANTITRUST
LITIGATION

MDL DOCKET 162-Civ-JLK

PRELIMINARY INJUNCTION

This matter came before the Court on Plaintiff's First Motion for Temporary Restraining Order dated June 18, 1976. Pursuant to notice supplied to all parties to this action and to the California Attorney General, the New Jersey Attorney General, the Missouri Attorney General, the Ohio Attorney General, the Wisconsin Attorney General, the Pennsylvania Attorney General, the Texas Attorney General, the New York City Department of Consumer Affairs, the Bank of America and the Superior Court of the State of California, County of Los Angeles, this matter was heard before the Court on June 30, 1976. The following appearances were made by counsel for the various parties:

Carl H. Hoffman
James H. Joseph
Lead Counsel for Plaintiffs

Herschel T. Elkins
Deputy Attorney General, State of California

William Hoeveler
Robert Paul
Counsel for Defendants, Richard Grillo, Melvin Morgan and Janin, Morgan & Brenner

J. Russell Pitto
Counsel for Defendants, Bestline Products, Inc., Bestline Corp., James K. Hisler, Jerry G. Brassfield, Oliver P. Colvin, David Soto, Norman Miller and Richard Dumont

Mare M. Watson
Counsel for Defendants, Gordon Blaum, Edna Blaum, James Herbert, Marvin Sternberg and George Wunch

Having heard and considered the evidence, briefs and oral argument submitted by the parties and the California Attorney General, the Court finds:

FINDINGS OF FACT

On December 21, 1973, Defendant, Bestline Products, Inc., (Bestline) entered into an "Agreement, Instructions to Compliance Officer and Trust" with the California Attorney General which was incorporated into a "Modified Judgment" entered on December 21, 1973, by the California Superior Court for Los Angeles County in Case No. C 2842. Pursuant to said "Modified Judgment," there was established a restitutionary plan (California Plan) which provided for restitutionary payments to (a) Bestline Distributors in the State of California who became such after January 14, 1971, (b)

Bestline Distributors within and without the State of California who are entitled to restitution pursuant to any agreements reached between any other state or political subdivision thereof or any federal department or agency and Bestline, and (c) any other distributor (i) as to whom Bestline approves their claim, or (ii) who has received an arbitration award pursuant to a national plan of arbitration, or (iii) pursuant to judgment. It appears that the great majority of participants in the California Plan became entitled to receive payments thereunder by virtue of options (a) and (b) above. Very few, if any, participants have actually obtained judgment against Bestline on their own behalf. It is noted that under option (c)(i) above all members of the Plaintiff class would have been entitled to participate in the California Plan from its inception had their claims been approved by Bestline. In addition, under option (c)(iii) above, all members of the Plaintiff class are entitled to participate in the California Plan upon entry of judgment on their behalf, without more.

As a part of the California Plan there was established a trust wherein Bestline agreed to transfer certain funds to the Bank of America, as trustee, for subsequent distribution to persons who were determined to be entitled to restitutionary payments in accordance with the terms of the "Modified Judgment." At the present time, there are some 7,043 participants in the California Plan who are entitled to such payments.

The "Agreement, Instructions to Compliance Officer and Trust" included a schedule of payments to be made by Bestline into the trust. Pursuant thereto, Bestline is scheduled on or about June 30, 1976, to transfer to the Bank of America for distribution shortly

thereafter to participants in the California Plan the sum of $500,000.00, or 50% of the pretax profits of Bestline, whichever is greater.

At the present time, in accordance with the terms of the "Modified Judgment," Bestline has available for transfer to the Bank of America the sum of $500,000.00. In anticipation of receiving this amount on June 30, 1976, the Bank of America has prepared some 7,043 checks in the average amount of $71.00 each for distribution to the participants in the California Plan. In connection with the preparation for such distribution, the Bank of America has incurred expenses in the approximate amount of $15,000.00, including the cost of postage and envelopes addressed to each of the California Plan participants.

The Participants in the California Plan are for the most part persons who would have been entitled to participate in this action as members of the Plaintiff class had they not elected to participate in the California Plan. In fact, it appears that a substantial number of Bestline investors may have been faced with the decision of electing to participate in either this action or the California Plan to the exclusion of the other.

The participants in the California Plan have previously received payments thereunder in partial restitution of the amounts paid by them to Bestline. As of this date, a total of approximately $7,336,000.00 has been so paid. However, no individual participant has been repaid in full nor will any such participant be repaid in full as a result of the payments scheduled to be made from the $500,000.00 presently held by Bestline.

For the most part, the participants in the California Plan have received only a small percentage of the total repayment due to them.

On March 19, 1976, this Court determined that Bestline is liable to the Plaintiff class under Section 12(1) of the Securities Act of 1933. Accordingly, the Plaintiff class will be entitled to final judgment against Bestline as soon as the amount of damages is determined. However, such determination will not be accomplished for several months because of the administrative delay necessarily involved therein. It is reasonably anticipated that each member of the Plaintiff Class will be entitled to recover from Bestline a sum in the approximate amount of $3,000.00 or more, which amount is essentially the same as the recovery to which each participant in the California Plan is entitled. It should be emphasized that most if not all of the participants in the California Plan are by definition members of the Plaintiff class.

It appears that approximately 20,000 members of the Plaintiff class may be entitled to recovery in this action under Section 12(1) of the Securities Act of 1933. However, Bestline has made no restitutionary payments of any kind to the members of the Plaintiff class who were not also participants in the California Plan. Moreover, Bestline does not have sufficient assets to satisfy the claims of the entire Plaintiff class, nor, for that matter, does Bestline have sufficient assets to satisfy the remaining claims of the California Plan participants.

CONCLUSIONS OF LAW

The Court finds that it will be virtually impossible to recoup the $500,000.00 which is scheduled for payment to the Bank of America on June 30, 1976, once this amount has been divided into small payments and distributed to the participants in the California Plan. Accordingly, if the other members of the Plaintiff class are in any way entitled to receive any part of the scheduled $500,000.00 payment, it is clear that the Plaintiff class will suffer irreparable harm once the scheduled payment is made and distributed.

Because this Court has previously determined that Bestline is liable to the Plaintiff class for full restitution, the members thereof will be entitled to recover an amount equal to their total investment in Bestline. A conservative estimate is that this amount will exceed $60,000,000.00. Therefore, there is no likelihood that the $500,000.00 presently under consideration will even approach the total recovery due to the Plaintiff class. In contrast, it is estimated that the total amount due to the participants in the California Plan is approximately $22,000,000, of which they have previously been repaid approximately $7,336,000.00 pursuant to the terms of the Plan. This Court has not been presented with any facts which would establish that the participants in the California Plan were entitled to a prior equity which would preclude the other members of the Plaintiff class from sharing with them on a pro rata basis in any recovery from Bestline. To the contrary, it would appear that whether any particular Bestline investor was allowed to participate in the California Plan was merely dependent upon his place of residence, the whims of Bestline, or other matters over which the individual

investor exercised little if any real control. Under the terms of the "Modified Judgment" it was Bestline alone who had the complete, unilateral and unreviewable power to designate the beneficiaries of the California trust, i.e., the participants in the California Plan. Accordingly, this Court concludes that it would be inequitable to allow the California Plan participants to continue to receive payments from Bestline where the other members of the Plaintiff class were effectively precluded from participating in the California Plan because of matters outside of their control. Moreover, in view of Bestline's overwhelming liability to the Plaintiff class, including the California Plan participants, and Bestline's comparatively weak financial condition, the Court concludes that the sum of $500,000.00 presently held by Bestline should be transferred to the registry of this Court to protect the integrity thereof for the benefit of the Plaintiff class.

It is therefore

ORDERED AND ADJUDGED as follows:

1. Defendants, Bestline Products, Inc. and Bestline Corporation, their officers, agents, servants, employees, attorneys, representatives, affiliates and all persons in active concert or participation with them, are hereby enjoined and restrained, pending further order of this Court, from transferring any funds or other things of value to the Bank of America, the California Restitutionary Trust, or to any other person, firm or corporation, except in the ordinary course of business for value received.

2. Defendant, Bestline Products, Inc., shall forthwith pay into the registry of this Court the sum of $500,000.00 which is presently held by Bestline for the June 30, 1976, payment under the California Plan.

3. Pending further order of this Court, the Clerk of this Court is directed to deposit and hold in interest bearing form any and all funds paid into the registry of this Court pursuant to this order.

4. Within five (5) days from the date of this order, Counsel for Bestline shall prepare a letter explaining to the participants in the California Plan the relevant terms of this order and its effect upon their expected receipt of restitutionary payments. Said letter shall be reviewed and approved by the California Attorney General and lead counsel for the Plaintiff class. After the letter is so approved, counsel for Bestline shall mail a copy thereof to each participant in the California Plan in the envelopes previously prepared by the Bank of America for distribution of the June 30, 1976, payment.

5. The expenses incurred by the Bank of America in preparation for distribution of the June 30, 1976, payment shall be paid by the Clerk of this Court from the funds paid into the registry of this Court pursuant to this order.

6. The funds deposited into the registry of this Court pursuant to this order and the interest received thereon shall constitute security for the payment of such

costs and damages as may be incurred or suffered by any party who is found to have been wrongfully enjoined hereunder.

DONE AND ORDERED at Miami, Florida, this 7th day of July, 1976.

/s/ James Lawrence King
JAMES LAWRENCE KING
UNITED STATES
DISTRICT JUDGE

cc: all counsel

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

NOS. 76-3495
77-2045

PETER PIAMBINO, et al.
Plaintiffs-Appellees,

vs.

WILLIAM E. BAILEY, et al.
Defendants,

DAVID SYLVA,
Intervenor-Appellant.

Appeal from the United States District Court
For the Southern District of Florida

PETITION FOR REHEARING OF
PLAINTIFFS-APPELLEES
PETER PIAMBINO, et al.

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PETITION FOR REHEARING

Pursuant to the provisions of Rule 40(a) of the Federal Rules of Appellate Procedure, Plaintiffs-Appellants, Peter Piambino, et al., respectfully petition this Court to grant a rehearing and reconsideration of the Appeal in the above-entitled cause. In support of this Petition, Plaintiffs represent to the Court as follows:

INTRODUCTION

Because this Court's Opinion encompassed issues and factual determinations not briefed by the parties to this Appeal, many of the factual matters relevant to this Petition for Rehearing were not before the court and were not contained in the Appendix filed by Appellant. Consequently, in this Petition the following symbols will be used for reference to supporting factual data:

ABBREVIATION	DESCRIPTION
A	Factual matter contained in Appendix (followed by Appendix page reference).
R	Factual matter of Record in lower court but not included in Appendix (followed by lower court's docket entry reference).
S	Factual matter supported by substantial evidence which has not yet been presented in the lower court (followed by supplemental Appendix page reference where applicable. The symbol "X" will be used for materials not contained in the Supplemental Appendix).

The various categories of participants in this action will be referred to as follows:

Plaintiff Class	All persons who were given notice of this action.
California Class	All participants in the California Restitutionary Fund.
Non-California Class	All persons who were given notice of this action and were *not* participants in the California Restitutionary Fund.
Claimants	All persons who filed Proofs of Claim in this action.
California Claimants	Participants in the California Restitutionary Fund who also filed Proofs of Claim in this action.
Non-California Claimants	All persons who filed Proofs of Claim in this action and who were *not* participants in the California Restitutionary Fund.

STATEMENT OF FACTS

The settlement referred to by this Court as the "Bestline Settlement" (slip op. p. 2949) involved settlement with twenty-two (22) individual defendants who were not involved in any respect in the California Superior Court action. A,855; cf. A,883. The most important of these additional defendants was Defendant, Jerry G. Brassfield, who had personally guaranteed certain terms of the "Bestline Settlement." A,537. Five of the individual settling defendants had been defendants in the California Superior Court Action, but they were not ordered to make restitution: *Only* Bestline Corporation, Bestline Products, Inc., and William E. Bailey were parties to the Modified Judgment and the restitutionary provisions thereof. A,88. Participation in the California Restitutionary Program did *not* involve or require the release of the twenty seven (27) individual settling defendants. A,295-296.

The source of monies recovered pursuant to the "Bestline Settlement" was as follows:

> $900,000.00 withdrawn from a Swiss bank in favor of John T. Dawson, Trustee. S,1. Mr. Dawson was the personal attorney for various individual defendants but did not make an appearance in this action.
>
> $300,000.00 drawn on the "Trustee Account" of John T. Dawson. S,3,4.
>
> $3,402.72 drawn on the account of Dawson, Maino, Chapman, Mattern and Bishop. S,5,6.

$229,837.29 received from sale of Bestline property *in Illinois.* S,7-9.

$491,636.59 transferred from the LaSalle Bank in Chicago, Illinois. S,10.

The above monies were distributed[1] as follows:

$756,950.04 to 2,525 Non-California Claimants.

$422,673.68 to 1,807 California Claimants.

$375,000 to James H. Joseph, P.A. as attorneys fees.

$375,000 to Carl H. Hoffman, P.A. as attorneys fees.

On a percentage basis, response to the Notice in this action by the *California Class* was more than double the response by the *Non-California Class.* S,X. In addition, the percentage response by the *California Class* was substantially better than the response in each of two similar class action cases where the notice was held to be adequate. Comparative data relating to class action participation is as follows:

Class Action Participation — Comparative Data

	Bestline Total	Bestline Non-Calif	Bestline Calif	Detroit*	Korn**
Notices Delivered	25,221	18,780	6,441	89,000	667
Proofs of Claim filed	4,332	2,525	1,807	14,156	122
Percentage Filing Proofs of Claim	17%	13%	28%	15%	18%

*Detroit v. Grinnell Corp., 495 F.2d 448 (2d Cir. 1974)
**Korn v. Franchard Corp., 456 F.2d 1206 (2d Cir. 1972)

Bestline was not insolvent when it filed its Chapter XI Bankruptcy Petition in the Northern District of California in July, 1973, A,457. In fact, Bestline had more than $27,000,000.00 available for levy on execution at that time. A,457. Although the avowed purpose of the California Restitution Program may have been to keep Bestline afloat to maximize restitution, Bestline had sufficient assets in July, 1973 to provide immediate full restitution for the California Class and the claimants in this action as well. From all appearances, Bestline principals urged this program as a part of a scheme to escape liability and remove the major part of Bestline's assets into foreign countries. A,446-503. For example, at the time of the "Bestline Settlement", Bestline was insolvent and had been insolvent for a substantial period of time prior thereto. A,456-460. The financial condition of Bestline at various times significant to this litigation was as follows:

Date	Event	Bestline Cash On Hand (A459)	Bestline Assets Available For Levy (A459)(A457)
6-13-73	California Superior Court Trial Ends.		
7-23-73	Bestline files bankruptcy petition in N.D. California.	$4,505,803	$27,052,207
7-25-73	California Superior Court issues written judgment and order		
8-1-73	Defendant Brassfield gains control of Bestline		
11-?-73	Bestline receives $3,000,000 tax refund (R,1169)	1,920,340	13,110,232
12-21-73	Modified Judgment entered and Bestline bankruptcy withdrawn		
1-31-74	First payment from California Restitutionary Fund	1,558,216	12,502,159
5-3-74	Multi-District Panel transfers Bestline Cases to S.D. Florida	513,916	3,605,185
6-?-74	Bestline receives $4,000,000 tax refund (R,1169)		
6-30-74	Second Payment from California Restitutionary Fund	55,227	2,426,675
6-30-76	S.D. Florida enjoins Bestline from Bench	159,368	-0-

[1]The distribution amounts include some accrued interest and therefore somewhat exceed the amount of monies recovered. There presently remains undistributed approximately $24,000.00

At all times after June 30, 1976, Bestline was insolvent and from an accounting standpoint had no assets available for levy. A,456-460. Well prior to that date, Bestline principals had removed Bestline's assets into foreign countries beyond the jurisdiction of the California Superior Court or the Southern District of Florida. A,446-503. Bestline's real estate, consisting of a warehouse in San Jose, California and a plant in Illinois remained the only substantial assets subject to the jurisdiction of any Court within the United States. However, under the terms of the Modified Judgment, property outside of the State of California was not subject to acquisition by the California Attorney General or receiver to be appointed in the event of a default. A,89.

Shortly before the trial court issued the Preliminary Injunction in June, 1976, the California Attorney General admitted in open court that he was aware that Bestline money was being used to pay the debts of Golden Products, Inc., a defunct corporation which had been operated by Defendant Brassfield prior to his acquisition of Bestline on August 1, 1973. A,488-490; A,474,475; A,274. Moreover, the California Attorney General approved this practice. A,274-275. At the time the Preliminary Injunction was issued, $1,176,553.48 had been removed from Bestline in this fashion *alone*. A,475.

Millions of dollars, including an $8.5 million tax refund, were also diverted from Bestline while the California Attorney General and the Bestline "financial officer" were supposed to be monitoring Bestline's operations. A,446-503; A,263-303. In fact, the Internal Revenue Service is now seeking deficiencies in the

amount of $16,604,909.00 from Defendant Brassfield arising out of his pyramid scheme operations. *See Brassfield v. Commissioner of Internal Revenue Service,* Tax Court Docket No. 338678.

SUMMARY OF THE ARGUMENT

Bestline never made a profit after entry of the California Superior Court Modified Judgment and was insolvent well prior to entry of the Preliminary Injunction and at all times thereafter. There is no evidence that Bestline would have continued to make payments to the California Restitutionary Fund if the Preliminary Injunction had not been entered in this action.

The Bestline Settlement was primarily a settlement with 27 individual defendants who had no obligation under the California Superior Court judgment. These 27 individuals paid most of the money comprising the Bestline Settlement. Moreover, the California Class had no claim on Bestline's assets outside of the State of California. Therefore, this Court's finding that this litigation generated no common fund is not consistent with the facts of this case.

Almost 2,000 California class members *did not* find the Class Notice and Proof of Claim confusing. Sylva himself was aware of the Notice and testified that he did not believe the Notice was generally confusing. Each of the witnesses offered by Sylva failed to file Proofs of Claim for reasons other than misinterpretation of the claim form.

As Trustee, Sylva was in a position to file Proofs of Claim for all members of the California Class but failed to do so. He was also in a position to notify all members of the California Class of their rights in this action but he failed to do so. All of the matters complained of by Sylva arose out of his own failure to carry out his fiduciary duties. Sylva is now unable to carry out his fiduciary duties in this action because the course of action urged by him would create irreconcilable conflicts among the various members of the California Class.

Under the terms of the Modified Judgment, any Bestline Distributor could participate in the California Restitutionary Fund if Bestline approved his claim. Therefore, the Bestline settlement with the Plaintiff Class resulted in the entire Plaintiff Class becoming members of the California Class. Because Bestline is now insolvent, any return of monies to Bestline will most probably be distributed pursuant to involuntary bankruptcy proceedings.

ARGUMENT

THIS ACTION CREATED A COMMON FUND FOR THE ENTIRE PLAINTIFF CLASS

A. *Most of the Settlement Proceeds were Provided by Individual Defendants.*

This Court held that the Bestline settlement must be vacated because the California Class had an absolute priority to the funds received in the settlement. Slip op.

p.2592. The basis of the priority is a finding of fact made by the Panel that but for the injunction, the California Class either (a) would have been paid the entire amount scheduled pursuant to the Restitutionary Plan or, (b) would have obtained, through a process of liquidation, the funds from which the Bestline settlement was paid. These findings are not consistent with the evidence in this case.

Since the "Bestline settlement" was in fact a settlement with 27 individual defendants as well as the Bestline corporations, the source of the settlement funds is of overriding importance. Any monies paid by the individual defendants are not subject to claim by the California Restitutionary Program since that program did not involve or require the release of any of the 27 individual settling defendants.

In fact, $1,203,402.72 of the Bestline settlement proceeds were provided by the individual defendants. In this respect, it is significant that Sylva repeatedly asserted in the trial court that he did not want to set aside the Bestline settlement. A,781, 743. Consequently, Sylva apparently does not contest the source of this major portion of the settlement funds. The remaining $721,473.00 is comprised of $491,636.00 transferred from the La Salle Bank in Chicago pursuant to the July 7, 1976 Preliminary Injunction and $229,837.00 received from the sale of Bestline Illinois property.

The California Modified Judgment provided that the California receiver had access *only* to Bestline assets *within* California. A,89-90. Consistent with this territorial limitation, Sylva has not argued that he is entitled to any interest in the Bestline property in Illinois.

Sylva's claim in the lower court was limited to the $491,636.00 which was transferred to the Southern District of Florida pursuant to the Preliminary Injunction. A,736. At best, Sylva may argue that Bestline *intended* to pay that amount into the California Restitutionary Program although Bestline's intent hardly gives the California Court jurisdiction of assets outside of the State of California. Moreover, most of the $491,636.00, or some $422,673.00, has already been returned to the California Claimants who filed Proofs of Claim in this action. Therefore, *at most,* Sylva's claim is limited to the $68,968.00 difference between the amount transferred pursuant to the Preliminary Injunction and the amount actually distributed to California claimants.

B. *No Class Member Should be Preferred Over Another.*

California Claimants shared ratably in the distribution of the settlement proceeds. Each California Claimant was paid on the same basis as Non-California Claimants: An adjusted claim was calculated by first subtracting from the claimant's expenditures any profits made by him on sales and any prior restitutionary payments received by him. The claimant was then paid in the same ratio of the total settlement proceeds as his adjusted claim bore to the adjusted claims of all claimants.

The well-established rule for distribution of settlement funds and treatment of class members is that no class member is to be preferred over any other class member. That was precisely the rule followed by lead counsel in this action.

C. *The California Class Lost No Rights Because of This Action.*

As discussed above, no more than $491,636.00 was available to the California class through the California Restitutionary Fund. Because the California class members had previously waived their rights to pursue any claims against Bestline, this court opined that it might have been improper to have included members of the California Class in this action. Slip. op. p.2952. However, as discussed above, none of the 27 individual settling Defendants had previously settled with the California class. As to the Bestline corporations who had already settled with the California class, Bestline's agreement to include the members of the California class in the settlement despite their prior waivers is hardly prejudicial to them.

At the time the California Superior Court entered its judgment on July, 1973, the Bestline Corporations had available for levy on execution the sum of $27,052,207.00. A,456-457. At about this same time, Bailey sold his interest in Bestline to Defendant Brassfield. Slip. op. p.2928. Brassfield had not been a party to the California Superior Court action (A,83) and consequently he was not personally involved in the Modified Judgment. After taking control, Brassfield transferred to Switzerland and other foreign countries essentially every liquid asset held by Bestline. *See* A,446-503. At the time of the settlement, Bestline had a negative net worth. A,459; A446-503.

One wonders what the California Attorney General and Sylva were doing when this was occurring. In fact, the California Attorney General had full knowledge that

more than $1,000,000 was paid by Bestline to satisfy a liability incurred by Defendant Brassfield when he was not affiliated with Bestline. A,457, 474-475. This money was paid into another California Restitutionary Plan established by the California Attorney General for distributors of Golden Products, Inc., a completely different pyramid scheme operated by Defendant Brassfield in competition with Bestline. A,475. Additionally, the few assets which were available within the jurisdiction of the California Restitutionary Plan had been liquidated and transferred to other areas outside the jurisdiction of the California Superior Court. A,446-503. In light of these facts, the Bestline settlement was not unreasonable for the California Class or for the Plaintiff Class as a whole.

THE NOTICE TO THE CLASS WAS NOT INADEQUATE

The California Class consisted of 7,043 persons, including 602 General Distributors. However, Sylva did not claim these 602 General Distributors to be part of his "class" for purposes of intervention. A,776. Consequently, only 6,441 members of the California Class were eligible to receive notice of the Florida action. Of this number, 1,807 California Class Members filed Proofs of Claim in the Florida action. Accordingly, at least 1,807 California Class Members *did not* find the notice confusing. In fact, Sylva himself testified that the number of people contacting him for clarification of the notice was not sufficient to cause him to believe there was a general problem of interpretation among all members of the California Class. A,839.

Of the three witnesses offered by Sylva, one of them, Norman Feinberg, testified that he did not file a Proof of Claim form because of advice he had gotten from three lawyers (A,808) and a notice that he believed had been sent by Sylva about a year prior to receiving the class notice. A,810-811. The other two witnesses, Valentin Dominguez and Susie Rosenrot, both spoke English with heavy accents and clearly would have difficulty understanding any detailed document in English. And even so, the reason for Mr. Dominguez's confusion was not the information contained in the notice but rather a letter he had earlier received from Bestline. A,814-15. The third witness, Susie Rosenrot, wrote to Sylva and despite his advice that she submit a claim form, she failed to do so. As stated by Ms. Rosenrot:

> Q. Didn't [Sylva's letter] say if you filled out the claim form and filed it in Florida it would not jeopardize your participation in California?
>
> A. That's what he said. But you know I don't speak too good English, you know; so I figure it was alright, you know.

A,829.

Also, while the notice to the class may appear complex, it was essentially identical to notices submitted in numerous other class actions. *See* 2 *Newberg on Class Actions*, pp. 297-1167.

The District Court specifically found that the notice was adequate and constituted "Valid, due and sufficient notice". A,854. This finding was made after the District Court had heard the testimony presented by Sylva. Accordingly, the trial court's finding may not be set aside unless it is "clearly erroneous." In view of the contradictions in the witnesses testimony as well as the similarity between the notice in this case and those submitted in many other cases, it cannot be said that the trial court's finding was clearly erroneous.

SYLVA HAS A CONFLICT OF INTEREST WHICH PRECLUDES HIS REPRESENTATION OF THE CALIFORNIA CLASS

Although not argued by Sylva, this Court found that Sylva in his capacity as Compliance Officer was in fact a Trustee and consequently had a "direct, substantial, and legally protectable interest" in these proceedings. Slip. op. p. 2944. Nonetheless, Sylva had a serious conflict that precluded his suitability to act in such capacity in this case: A total of 1,807 Proofs of Claim (40% of the total Proofs of Claim filed) were filed by members of the California Class. The California Class consisted of a total of 7,043 persons (slip op. p. 2935) of which 602 were General Distributors. A,755-756. Despite his fiduciary duty, Sylva specifically disclaimed these 602 General Distributors to be part of his "class" for purposes of intervention. A,776.

Sylva repeatedly represented in the trial court that he did *not* want to set aside the settlement. A,781, 743. But, Sylva had an irreconcilable conflict in his class of 6,441 persons (7,043 total minus 603 General Distributors), 1,807 of whom were already entitled to share in the settlement proceeds. His successful intervention would only succeed in reducing the amount of money the 1,807 would receive as claimants in the Florida class. Of course, Sylva also had a conflict with the 602 General Distributors who would receive nothing if Sylva opted to merely share in the settlement proceeds rather than regain for the California fund the $491,636 transferred pursuant to the Preliminary Injunction. But if this $491,636 were removed to the California fund, the 1,807 persons who had filed Proofs of Claim in the Florida action would be prejudiced since the $491,636 would have to be divided among 7,043 persons in the California fund as opposed to 4,332 persons in the Florida action. This conflict was admitted by Sylva in the trial court (A,747), but no solution was offered.

Even if Sylva were somehow able to resolve this conflict, it is noted that Sylva has not acted for the benefit of his class. As a Trustee, Sylva should have filed Proofs of Claim for all members of the California Class. As a Trustee he not only had the right to do so, but the obligation. Instead of doing this, Sylva elected to intervene as a class representative under Rule 23, which he clearly was not. Of course, there would have been no attorney's fees or compliance officer fees awardable if Sylva merely filed the Proofs of Claim. However, there was no proper reason for failure to file the Proofs of Claim. Sylva indicated that the same claim form had already been filled out and processed by him through

the Restitutionary Program so that no administrative difficulty would have been involved in filing the Proofs of Claim. A,768-769.

At least as early as December 15, 1976, or shortly thereafter, Sylva was aware that Proofs of Claim had been submitted to participants in the California Restitutionary Program. A,835. In fact, he answered inquiries concerning the Proof of Claim and *even developed a form letter* to deal with inquiries from members of the California Class. A,835. If he in fact believed that the notice was confusing to members of the California Class, he should have at least supplied all of them with a form letter urging them to participate. He did not do this.

It should be noted that Sylva's position as Trustee on behalf of a limited group is quite different from that of Lead Counsel who had a fiduciary duty to treat all class members equally. To encourage any particular claimant or group of claimants to file Proofs of Claim would prejudice the others. Consequently, it would have been improper for Lead Counsel to suggest to Sylva that he file Proofs of Claim *even if* Sylva had represented that he was a Trustee for the members of the California class — which he did not.

Plaintiffs are uncertain as to just what results Sylva may be seeking in this Appeal: If the "Bestline Settlement" were disapproved, the 27 individual settling defendants would be entitled to a refund of the $1,203,402.74 paid by them. Similarly, Bestline would be entitled to refund of the $229,837.29 received from the sale of the Bestline property in Illinois and the $491,636.59 transferred from the LaSalle Bank in Chicago, Illinois. However, *Bestline is and was*

insolvent. Therefore, any three creditors, including any three members of the Plaintiff Class, may petition for Bestline's involuntary bankruptcy thereby forcing distribution of these funds among at least 9,568 persons (7,043 California class members plus 2,535 Non-California class members) resulting in an average per capita distribution of $75 person. Of course this calculation does not account for claims by general creditors. In contrast, it is noted that the 1,807 California claimants who did file Proofs of Claim in this action have received an average per capita distribution of $233.90 which they would be required to disgorge if the settlement were disapproved.

The California class members would be required to file another Proof of Claim with the Bankruptcy Court in order to participate in any bankruptcy distribution. Consequently, it is probably not unrealistic to expect the California claimants to be limited to the same diligent 1,807 persons who filed Proofs of Claim in this action. Therefore, it is most probable that any disapproval of the Bestline Settlement will only result in the loss of the $1,203,402.74 paid by the 27 individual settling defendants with little reallocation of settlement proceeds among the California class members.

On the other hand, if the Bestline Settlement were approved on the condition that the California class given be absolute priority to the monies obtained from Bestline and the sale of Bestline's property, regardless of its location, the California class would not fare any better: Under the terms of the Modified Judgment, any Bestline Direct Distributor could participate in the California Restitutionary Fund if Bestline approved his claim. A,105. Bestline's settlement with the Plaintiff Class constituted approval of the Plaintiff Class claims

and thereby entitled the entire Plaintiff Class to become members of the California Class. The result, again, would be the distribution of $721,473.88 among 9,568 persons, resulting in the same average per capita distribution of $75 per person. Of course, the California Class would in this case be allowed to participate in the proceeds received by the individual defendants. But there remains a further consideration: As members of the California Class the Plaintiff Class members were entitled to participate in all distributions effected by Sylva after Bestline's approval of the settlement. At least $250,000 was distributed by Sylva after such approval. A,840-841. Therefore, the Non-California Claimants in this action are entitled to receive an additional average per capita distribution of at least $26.12 from the California Restitutionary Fund ($250,000 divided by 9,568) for a total of $65,975.12. Consequently, it is most doubtful that any real benefit would accrue to any class member by restructuring the settlement.

CONCLUSION

For the foregoing reasons, Plaintiffs/Appellees, Peter Piambino, et al. pray the Court for rehearing and that on rehearing granted, this Court's Opinion dated February 6, 1980, be vacated and that the Court enter a new Opinion affirming the District Court's approval of the Bestline settlement, or, in the alternative, remanding this action for further findings of fact with reference thereto.

CARL H. HOFFMAN, P. A.

By:_____

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that an original and one copy of the foregoing Petition for Rehearing was mailed or delivered to each attorney of record this____ day of May, 1980.

CARL H. HOFFMAN, P.A.
Attorneys for Appellees,
Peter Piambino, et al.
2660 AmeriFirst Building
One Southeast Third Avenue
Miami, Florida 33131

By:_____

APPENDIX D

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

NOS. 76-3495 77-2045

PETER PIAMBINO, et al.
Plaintiffs-Appellees,

vs.

WILLIAM E. BAILEY, et al.
Defendants.

DAVID SYLVA,
Intervenor-Appellant.

CERTIFICATE REQUIRED BY FIFTH CIRCUIT LOCAL RULE 13.6.1

The undersigned, counsel of record for Appellees, certifies that the following listed parties have an interest in the outcome of this case. These representations are made in order that the Judges of this Court may evaluate possible disqualification or recusal pursuant to Local Rule 13.6.1.

NAME	INTEREST
Peter Piambino	Plaintiff
Joseph F. Kucklick	Plaintiff
Marilyn Koslen	Plaintiff
Robert M. Ernst	Plaintiff
Michael J. Gardner	Plaintiff
James D. Small	Plaintiff
All persons who purchased or invested in Director Distributorships during the period from March 7, 1980 through August 10, 1973	Members of the Plaintiff Class
Bestline Products, Inc.	Defendant
Bestline Corporation	Defendant
William E. Bailey	Defendant
David L. Eastis	Defendant
Jerry G. Brassfield	Defendant
Robert Depew	Defendant
Leo Diel	Defendant
Charles Simmons	Defendant
Larry D. Huff	Defendant
Larry S. Huff	Defendant
James Rohn	Defendant
Towru Ikeda	Defendant

Steve C. Stern	Defendant
James K. Hisler	Defendant
Ralph Flynn	Defendant
Martin Day	Defendant
Norman Miller	Defendant
Joseph Cotroneo	Defendant
Richard Dumont	Defendant
Saul Tave	Defendant
Richard Lub	Defendant
Jerry J. Weiss	Defendant
Davis Soto	Defendant
Keith Fox	Defendant
Oliver P. Colvin	Defendant
Tink Anderson	Defendant
Frank Brendis	Defendant
David T. Gibson	Defendant
Gordon Blaum	Defendant
Edna Blaum	Defendant
Richard Grillo	Defendant
Melvin Moran	Defendant
Richard G. Kruse	Defendant
Blair R. Egli	Defendant
Neal Morehart	Defendant
Peter Eiselstein	Defendant
Bert Hardcastle	Defendant
Alfred G. Moravec	Defendant
Kenneth Davis	Defendant
Norman Evans	Defendant
Carroll Gentry	Defendant
Robert E. Johnson	Defendant
Robert L. Shell	Defendant
C.D. St. Peter	Defendant
James Herbert	Defendant
Donald Omholt	Defendant

Sten Tallarida	Defendant
Willie Larkin	Defendant
Frank Conti	Defendant
Andi Dias	Defendant
Marvin Sternberg	Defendant
E. J. Beckman	Defendant
Kenneth Lutz	Defendant
Edward Buck	Defendant
John Wolfe	Defendant
Robert Schuster	Defendant
Robert Richards	Defendant
William Gelfound	Defendant
Lennart Osterman	Defendant
Jan B. Bailey	Defendant
Janin, Morgan & Brenner, a partnership	Defendant
Janin, Morgan & Brenner, a corporation	Defendant
Frank Interdonato	Defendant
George Wunch	Defendant
Robert Burke	Defendant
Wisconsin Attorney General's Office	
New Jersey Attorney General's Office	
Pennsylvania Attorney General's Office	
Missouri Attorney General's Office	
Texas Attorney General's Office	
California Attorney General's Office	California Restitutionary Program
New York Department of Consumer Affairs	

David R. Sylva Bank of America, N.T. & S.A.	Appellant Trustee, California Restitutionary Programs
All persons eligible for distributions from the California Restitutionary Program	California Restitutionary Program

CARL H. HOFFMAN

STATEMENT OF COUNSEL REQUIRED BY FIFTH CIRCUIT LOCAL RULE 16.1.2.2

I express a belief, based on a reasoned and studied professional judgment, that the panel decision is contrary to the following decisions of the United States Court of Appeals for the Fifth Circuit and of the Supreme Court of the United States and that consideration by the full Court is necessary to secure and maintain uniformity of decisions in this Court:

Bell v. Health-Mor, Inc.,
549 F.2d 342 (5th Cir. 1977)

Cameron v. Outdoor Resorts of America, Inc.,
608 F.2d 187 (5th Cir. 1979)

Commander's Palace Park v. Girard & Pastel Corp.,
572 F.2d 1084 (5th Cir. 1978)

International Brotherhood of Teamsters v. Daniel,
439 U.S. 551, 99 S.Ct. 790,
58 L.Ed.2d 808 (1979)

Joiner v. City of Dallas,
488 F.2d 519 (5th Cir. 1974)

Lynch v. Household Finance Corp.,
405 U.S. 538, 92 S.Ct. 1113,
31 L.Ed.2d 424 (1972)

Machesky v. Bizzell,
414 F.2d 283 (5th Cir. 1969)

SEC v. Koscot Interplanetary, Inc.,
497 F.2d 473 (5th Cir. 1974)

Tampa Phosphate R. Co. v. Seaboard Coast Line R. Co.,
418 F.2d 387 (5th Cir. 1969)

United Housing Foundation Inc. v. Forman,
421 U.S. 837, 95 S.Ct. 2051,
44 L.Ed.2d 621 (1975)

Carl H. Hoffman
Attorney for Appellees

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439 U.S. 551, 99 S.Ct. 790, 58 L.Ed.2d 808
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Lewis D. Lowenfels, Recent Supreme Court Decisions Under the Federal Securities Laws: The Pendulum Swings, 65 Geo.L.J. 891 (1977) D-25

STATEMENT OF THE ISSUES

The following issues are raised on this Petition for Rehearing en banc:

1. Whether the Panel's decision relating to the Anti-Injunction Act is contrary to the *Tampa Phosphate* and *Machesky* decision.

2. Whether the Panel's decision relating to the definition of a security is contrary to the *Koscot Interplanetary* decision.

3. Whether the Panel's decision relating to reversal of the Bestline Settlement is contrary to the established law of this Circuit.

STATEMENT OF COURSE OF PROCEEDINGS AND DISPOSITION OF THE CASE

The development of this case is adequately set forth in the Panel's Opinion appearing at 610 F.2d 1306. However, Plaintiffs do not necessarily agree with the Panel's characterization of events. For example, Plaintiffs disagree that Lead Counsel attempted to "disrupt" the California restitution payments. 610 F.2d at 1314. Rather, Lead Counsel properly sought to protect the rights of the Plaintiff class whom they represented. Likewise, Plaintiffs disagree that the California class was treated differently from the Plaintiff class as a whole. Quite to the contrary, special attention was given to insure there was no distinction of any kind in the treatment of the two groups. A,801.

STATEMENT OF THE FACTS

The specific facts of this Appeal are for the most part set forth in detail in the Panel's Opinion appearing at 610 F.2d 1306. However, the Panel's Opinion should be supplemented as follows:

The settlement referred to by the Panel as the "Bestline Settlement" (610 F.2d at 1327) involved settlement with twenty-two (22) individual defendants who were *not* involved in any respect in the California Superior Court action. A,855; cf. A,883. The most important of these additional defendants was Defendant, Jerry G. Brassfield, who had personally guaranteed certain terms of the "Bestline Settlement." A,537. Five of the individual settling defendants had been defendants in the California Superior Court Action, but they were *not* ordered to make restitution:

Only Bestline Corporation, Bestline Products, Inc., and William E. Bailey were parties to the Modified Judgment and restitionary provisions thereof. A,88. Participation in the California Restitutionary Program did *not* involve or require the release of the twenty seven (27) individual settling defendants. A,295-296.

The "Bestline Settlement" consisted of $1,200,000.00 paid by the 27 individual settling defendants, $230,000.00 received from the sale of Bestline property in Illinois and $491,000.00 transferred from the LaSalle Bank in Chicago pursuant to the District Court's Preliminary Injunction.

On a percentage basis, response to the notice in this action by the "California Class" was more than double the response by the "Non-California Class." In addition, the percentage response by the "California Class" was substantially better than the response in each of two similar class action cases where the notice was held to be adequate. Comparative data relating to class action participation is as follows:

Class Action Participation — Comparative Data

	Bestline Total	Bestline Non-Calif	Bestline Calif	Detroit*	Korn**
Notices Delivered	25,221	18,780	6,441	89,000	667
Proofs of Claim filed	4,332	2,525	1,807	14,156	122
Percentage Filing Proofs of Claim	17%	13%	28%	15%	18%

*Detroit v. Grinnell Corp., 495 F.2d 448 (2d Cir. 1974)
**Korn v. Franchard Corp., 456 F.2d 1206 (2d Cir. 1972)

Bestline was not insolvent when it filed its Chapter XI Bankruptcy Petition in the Northern District of California in July, 1973. A,457. In fact, Bestline had more than $27,000,000.00 available for levy on execution at that time. A,457. In July, 1973, Bestline had sufficient assets to provide immediate full restitution for the California Class and the claimants in this action as well. From all appearances, Bestline principals urged the California Restitutionary Program as a part of a scheme to escape liability and remove the major part of Bestline's assets into foreign countries. A,446-503. Consequently, at the time of the "Bestline Settlement", Bestline was insolvent and had been insolvent for a substantial period of time prior thereto. A,456-460. The financial condition of Bestline at various times significant to this litigation was as follows:

Date	Event	Bestline Cash On Hand (A459)	Bestline Assets Available For Levy (A459)(A457)
6-13-73	California Superior Court Trial Ends.		
7-23-73	Bestline files bankruptcy petition in N.D. California.	$4,505,803	$27,052,207
7-25-73	California Superior Court issues written judgment and order		
8-1-73	Defendant Brassfield gains control of Bestline		
11-?-73	Bestline receives $3,000,000 tax refund (R,1169)	1,920,340	13,110,232
12-21-73	Modified Judgment entered and Bestline bankruptcy withdrawn		
1-31-74	First payment from California Restitutionary Fund	1,558,216	12,502,159
5-3-74	Multi-District Panel transfers Bestline Cases to S.D. Florida	513,916	3,605,185
6-?-74	Bestline receives $4,000,000 tax refund (R,1169)		
6-30-74	Second Payment from California Restitutionary Fund	55,227	2,426,675
6-30-76	S.D. Florida enjoins Bestline from Bench	159,388	-0-

At all times after June 30, 1976, Bestline was insolvent and from an accounting standpoint had no assets available for levy. A,456-460. Well prior to that date, Bestline principals had removed Bestline's assets into foreign countries beyond the jurisdiction of the California Superior Court or the Southern District of Florida. A,446-503. Bestline's real estate, consisting of a warehouse in San Jose, California and a plant in Illinois remained the only substantial assets subject to the jurisdiction of any Court within the United States. However, under the terms of the Modified Judgment, property outside of the State of California was not subject to acquisition by the California Attorney General or receiver to be appointed in the event of a default. A,89.

Shortly before the trial court issued the Preliminary Injunction in June, 1976, the California Attorney General admitted in open court that he was aware that Bestline money was being used to pay the debts of Golden Products, Inc., a defunct corporation which had been operated by Defendant Brassfield prior to his acquisition of Bestline on August 1, 1973. A,488-490; A,474,475; A,274. Moreover, the California Attorney General approved this practice. A,274-275. At the time the Preliminary Injunction was issued, $1,176,553.48 had been removed from Bestline in this fashion *alone.* A,475.

Millions of dollars, including an $8.5 million tax refund, were also diverted from Bestline while the California Attorney General and the Bestline "financial officer" were supposed to be monitoring Bestline's operations. A,446-503; A,263-303. In fact, the Internal Revenue Service is now seeking deficiencies in the

amount of $16,604,909.00 from Defendant Brassfield arising out of his pyramid scheme operations. *See Brassfield v. Commissioner of Internal Revenue Service,* Tax Court Docket No. 338678.

It should be noted that Plaintiffs do not agree that the following statements by the Panel are consistent with the facts of this case:

The Compliance Officer has kept himself abreast of the litigation in Florida from its inception. 610 F.2d at 1323.

Not only did the District Court intend to liquidate Bestline's assets, but he intended to distribute the proceeds *only* to class members "who have not previously been admitted to participation in the California restitutionary fund." 610 F.2d at 1323.

At that time, the California fund had just made its second payment, and many of the participants undoubtedly were confused by this notice of yet another lawsuit. 610 F.2d at 1324.

As has already been demonstrated, there was a distinct probability that the confusing, if not deceptive, series of notices guaranteed that no members of the California group would appear at the hearing to protest the settlement. 610 F.2d at 1325.

[T]he District Court also intended to appoint a receiver with instructions to liquidate all of Bestline's assets. 610 F.2d at 1326.

Bailey gave no consideration whatsoever for the release of these claims. 610 F.2d at 1327.

This is demanded by the failure to assess the interests of the two categories of the plaintiffs and whether the settlement was fair, adequate and reasonable *as to each.* 610 F.2d at 1329.

Rather than execute their judgments and force Bestline into bankruptcy, those 7,043 people chose to accept smaller installment payments and to keep Bestline afloat for the greater good of all concerned. 610 F.2d at 1329.

Therefore the members of the fund have been deprived of over $600, on the average, to which they were entitled as a result of their judgments against Bestline. 610 F.2d at 1329.

The interest of these 7,043 people in protecting their judgments has not been adequately recognized or protected. 610 F.2d at 1329.

Furthermore, since those 7,043 people were already entitled to such funds (up to $4,500,000 plus interest), this litigation has generated no common fund from which to pay attorneys' fees and expenses. 610 F.2d at 1330.

If, however, Bestline would have defaulted on those payments before now, the California class would still have obtained Bestline's assets through liquidation long before this settlement. 610 F.2d at 1330.

While accepting generally the Panel's description of the facts of this case, Plaintiffs submit that the foregoing findings are erroneous and inconsistent with

the evidence of record herein. These matters have been addressed in Plaintiff's Petition for Rehearing filed concurrently herewith.

ARGUMENT

THE PANEL'S DECISION RELATING TO THE ANTI-INJUNCTION ACT IS CONTRARY TO THE TAMPA PHOSPHATE AND MACHESKY DECISIONS

The Panel's analysis of the District Court's issuance of the Preliminary Injunction places significant emphasis on the characterization of this action as a private lawsuit. 610 F.2d at 1332-1334. The Panel's conclusion "that for private lawsuits the Securities Exchange Act does not constitute an 'expressly authorized' exception to 27 U.S.C. §2283" (610 F.2d at 1333), is in direct conflict with this Court's holdings in *Machesky v. Bizzell,* 414 F.2d 283 (5th Cir. 1969) and *Tampa Phosphate R. Co. v. Seaboard Coast Line R. Co.,* 418 F.2d 387 (5th Cir. 1969).

Both *Machesky* and *Tampa Phosphate* recognized that §2283 is inapplicable in extraordinary cases where an injunction against state court proceedings is the only means to avoid grave and irreparable injury. In addition, both cases held that *a different result should not obtain,* when enforcement is sought by a private party rather than by the Securities and Exchange Commission. 414 F.2d at 288; 418 F.2d at 394. This Court cited with approval the case of *Studebaker Corp. v. Gittlin,* 360 F.2d 692 (2d Cir. 1966), stating:

> [I]n the opinion by Judge Friendly, the court found that §2283 was not a bar to a private action under the Securities and Exchange Act. 418 F.2d at 393.

Additionally, Plaintiffs would note that the Panel calls attention to *SEC v. Wencke*, 577 F.2d 619 (9th Cir. 1978), 610 F.2d at 1332, a case which squarely approved the district court's enjoining state court action as an exception to §2283. There the court observed:

> Rather than a genuine attempt to preserve the property for the corporation's shareholders and creditors, the state receivership was a protective cloak for Wencke to throw over his continued looting. *Id.* at 622.

In view of the dissipation of assets in the California Fund under the aegis of the California Attorney General and Sylva, the removal of Brassfield's protective cloak accomplished by the Preliminary Injunction would appear to take it outside of §2283. It should be emphasized that shortly before issuing the Preliminary Injunction, the trial court had heard the California Attorney General acknowledge that more than $1,000,000.00 had been paid by Bestline to satisfy a liability incurred by Defendant Brassfield prior to his affiliation with Bestline. A,457; 474-475. This money was paid into another California restitutionary plan established by the California Attorney General for distributors of Golden Products, Inc., a completely different pyramid scheme operated by Defendant Brassfield in competition with Bestline. A,475. The evidence before the trial court made it clear that neither

the California Attorney General nor Sylva were taking any steps to prevent the systematic depletion of Bestline's assets which had been occurring up to the time of the issuance of the Preliminary Injunction.

The Panel's opinion is also in direct conflict with this Court's holding in *Joiner v. City of Dallas, Texas,* 488 F.2d 519 (5th Cir. 1974), as well as the Supreme Court's holding in *Lynch v. Household Finance Corp.,* 405 U.S. 538, 92 S.Ct. 1113, 31 L.Ed.2d 424 (1972). In *Joiner,* plaintiffs sought to enjoin state condemnation proceedings in order to protect their property rights. The district court had ruled that an injunction against pending state court proceedings would be barred by §2283, reasoning that 42 U.S.C. §1981 et seq. did not apply to property rights. *Joiner v. City of Dallas,* 329 F.Supp. 943, 944 (N.D.Tex. 1971). This Court affirmed, 447 F.2d 1403, and the Supreme Court, without opinion, vacated and remanded for reconsideration in light of certain Supreme Court decisions. *Joiner v. City of Dallas,* 412 U.S. 902, 93 S.Ct. 2286, 36 L.Ed.2d 967 (1973). On remand this Court stated:

> Second, Lynch v. Household Finance Corp. held that §1983 protects property rights as well as personal liberties. The issue in *Lynch* was whether, in light of the anti-injunction statute, the District Court had jurisdiction to enjoin a summary pre-judicial garnishment proceeding permitted under Connecticut law but challenged under the due process clause as it applies to the states through the Fourteenth Amendment. The Court held that 42 U.S.C.A. §1983 and 28 U.S.C.A. §1343 provided an

> exception to the anti-injunction statute to protect property rights as well as personal liberties. Again, the *Joiner* decision was in direct conflict with this holding. 488 F.2d at 520.

Plaintiff's reliance on deprivation of property without due process of law to come within the §1983 exception to §2283 was summarily discounted (610 F.2d at 1332), reminiscent of the first *Joiner* opinion and in direct conflict with the later, correct *Joiner* decision. *See also Henry v. First National Bank of Clarksdale,* 595 F.2d 291, 300 (5th Cir. 1979).

In view of the above considerations, Plaintiffs submit that the district court properly entered the Preliminary Injunction and that the Panel's decision is not reconcilable with the prior law of this Circuit.

THE PANEL'S DECISION RELATING TO THE DEFINITION OF A SECURITY IS CONTRARY TO THE KOSCOT INTERPLANETARY DECISION

The Panel specifically found that there were two distinct aspects of the distribution system set up by Bestline, just as there had been in *SEC v. Koscot Interplanetary, Inc.* 497 F.2d 473 (5th Cir. 1974); *SEC v. Glenn W. Turner Enterprises, Inc.,* 474 F.2d 476 (9th Cir. 1973) *cert. denied* 414 U.S. 821, 94 S.Ct. 117, 38 L.Ed.2d 53 (1973); *SEC v. Galaxy Foods, Inc.,* 556 F.2d 559 (2d Cir. 1977) and *Bell v. Health-Mor, Inc.,* 549 F.2d 342 (5th Cir. 1977). 610 F.2d at 1318. These two aspects were described by the Panel as the "retail sales portion of the business on one hand and the recruiting portion

on the other." 610 F.2d at 1318. The Panel noted however:

> As is the case with most such pyramid sales schemes, however, the lure of big profits came not from the opportunity to sell Bestline's products to the consuming public but from the opportunity to recruit others who would in turn recruit or sell. 610 F.2d at 1310.

The Panel went on to conclude that "different inferences could be drawn from the facts in the record as to whether the Bestline Direct Distributorship Plan could be separated into two parts" and that "different inferences could be drawn from the facts in the record as to whether anticipated profits were to come solely by Bestline's efforts, with no substantial personal effort on the part of the 'investor'." 610 F.2d at 1319. However, this Court recognized in *Bell v. Health-Mor, supra,* "that income opportunity can be considered independently of any sale of a product or service which might have been made." 549 F.2d at 346. Of course, under the authority of *Koscot* and the other cases cited by the Panel, the test is not whether anticipated profits were to come *"solely* from Bestline's efforts with no substantial personal effort" by the Investor, but whether Bestline was to provide the "essential managerial efforts which affect the failure or success of the enterprise." *See SEC v. Koscot Interplanetary Inc.,* 497 F.2d at 483.

The Panel's opinion conflicts with the interpretations of the Supreme Court's decisions in *United Housing Foundation, Inc. v. Forman,* 421 U.S. 837, 95 S.Ct. 2051, 44 L.Ed.2d 621 (1975) and *International Brotherhood of Teamsters v. Daniel,* 439

U.S. 551, 99 S.Ct. 790, 58 L.Ed.2d 808 (1979), that are generally accepted by all commentators and Circuit Courts of Appeals, including the Fifth Circuit. *See* Lewis D. Lowenfels, *Recent Supreme Court Decisions Under the Federal Securities Laws: The Pendulum Swings,* 65 Geo.L.J. 891, 908 (1977). This court stated in *Cameron v. Outdoor Resorts of America, Inc.*, 608 F.2d 187 (5th Cir. 1979):

> The key issue is whether the managerial efforts are functionally essential or undeniably significant to that profit, and it is irrelevant that the investor does "nominal menial effort" that affects profit. *Id.* at 193.

Here, however, the Panel concluded that summary judgment was improper because "there was evidence that might lead the trier of fact to conclude that Bestline intended to dispel (and dispelled) the belief that it was promising profits with no expenditure of effort." 610 F.2d at 1319. This is simply inconsistent with this Court's finding in *Cameron* that "it is irrelevant that the investor does 'nominal menial effort' that affects profit."

Additionally the Panel's repeated emphasis on the word *solely* in the *Howey* test (a word significantly omitted by the Supreme Court in *Forman)* conflicts with this Court's pronouncement in *Commander's Palace Park v. Girard & Pastel Corp.*, 572 F.2d 1084 (5th Cir. 1978):

> In cases dealing with pyramid sales schemes or referral sales agreements, we have modified this test to allow that the promoter or the third party need expend not the sole efforts, but only the crucial efforts, to produce profits. *Id.* at 1086.

And in *Bell v. Health-Mor, Inc., supra,* this Court noted:

> [T]he assumption that *Howey* requires that the income be derived soley by the efforts of those other than the investor [was] specifically rejected . . . in *Koscot.* 549 F.2d at 346.

The shattering effect to the foundation of the Fifth Circuit's leadership on a question of such exceptional importance in the evolution of securities law surely renders this decision "enbancworthy."

The Panel specifically found that the Bestline Direct Distributorships were "an integral part of its multi-level distributorship system, a species of pyramid sales schemes." 610 F.2d at 1308. After finding that the Bestline Direct Distributorship was a part of Bestline's pyramid sales scheme, the Panel acknowledged that this Court specifically held in *Koscot* that a pyramid distribution system is a security. 610 F.2d at 1316. A reading of the Panel's decision, however, would lead one to believe that pyramid franchising schemes are no longer securities in the fifth Circuit despite the *Koscot* holding, and that it is necessary for victim of a pyramid franchising scheme to prove there was "no substantial effort by the investor." 610 F.2d at 1320. In contrast, the *Koscot* test related to the "undeniably significant ones,

those essential managerial efforts which affect the failure or success of the enterprise." 497 F.2d at 483.

The Panel found that the lure of "big" profits came not from the opportunity to sell Bestline products to the consuming public but from the opportunity to recruit others who would in turn recruit or sell. 610 F.2d at 1310. However, it is clear that no *reasonable* investor would seek out "small" profits. There can be no dispute as to the inference that every reasonable investor would seek out "big" profits rather than "small" profits thereby eliminating any question of inference or fact in the case at bar. Therefore, the District Court correctly found on summary judgment that the Bestline Direct Distributorship was a "security".

It is noted that the *Koscot* case consisted of an outright reversal of the District Court's findings that the Koscot distributorship was *not* a security. Clearly, the criteria for reversal of the District Court's findings of fact differ little from the criteria to be applied in favor of the non-moving party upon motion for summary judgment. Therefore, with *Koscot* for guidance, the District Court in this case was plainly justified in relying upon the *Koscot* criteria for entry of summary judgment. However, the Panel's decision reversing the District Court brings into doubt the applicability of the *Koscot* standards for future litigation.

THE PANEL'S DECISION RELATING TO REVERSAL OF THE BESTLINE SETTLEMENT IS CONTRARY TO THE ESTABLISHED LAW OF THIS CIRCUIT

The standards governing approval of settlements in class actions are well established in this circuit: *Young v. Katz,* 447 F.2d 431 (5th Cir. 1971); *Miller v. Republic National Life Ins. Co.,* 559 F.2d 426 (5th Cir. 1977); *Cotton v. Hinton,* 559 F.2d 1157 (5th Cir. 1977); *Pettway v. American Cast Iron Pipe Co.,* 576 F.2d 1157 (5th Cir. 1978); *In re Beef Industry Anti-trust Litigation,* 607 F.2d 167 (5th Cir. 1979). In the instant case, the trial judge in fact adhered meticulously to these standards, particularly in assessing "the interests of the two categories of Plaintiffs and whether the settlement was fair, adequate and reasonable *as to each.*" 610 F.2d at 1329. *See* A,801. The trial judge weighed the testimony of witnesses, sifted through the evidence and heard counsel's arguments before determining that the objections to the notice were meritless. The Panel's opinion is in direct conflict with this Court's pronouncement in *Harrison v. Flota Mercante Grancolombiana, S.A.,* 577 F.2d 968 (5th Cir. 1978):

> It is not our duty or right on appeal to sift through the evidence and determine whether we would have drawn the same inferences as did the trier of fact and would have resolved credibility determinations in a like fashion. *Id.* at 976.

However, the Panel was misled by Appellant into making direct, and unfortunately erroneous, findings of fact. The teachings of the Supreme Court are pertinent:

> When attention has been focused on other issues, or when the Court from which a case comes has expressed no views on a controlling question, it may be appropriate to remand the case rather than deal with the merits of that question in this Court. *Dandridge v. Williams,* 397 U.S. 471, 90 S.Ct. 1153, 25 L.Ed.2d 491 (1970).

This Court recognized in *Cotton v. Hinton, supra,* that each case must be decided on its own facts and that in determining whether a compromise is fair, adequate and reasonable, the trial judge is essentially called upon to do a balancing task. 559 F.2d at 1330. This Court has often asserted that in reviewing approval of settlement it has neither the right nor the duty to reach any ultimate conclusions on the issues of fact and law which underlie the merits of the dispute. 559 F.2d at 1330. In *Cotton* as well as the case at bar: "On appeal, the objectors present the same objections to us as were presented to and rejected by the trial judge." 559 F.2d at 1332.

The appellate court's function is to review cases; it neither tries nor retries fact issues. *Zenith Radio Corp. v. Hazeltine Research, Inc.,* 395 U.S. 100, 123, 89 S.Ct. 1562, 23 L.Ed.2d 129 (1969); *Hill York Corp. v. American International Franchises, Inc.,* 448 F.2d 680 (5th Cir. 1971); *Dickens v. United States,* 545 F.2d 886 (5th Cir. 1977). As stated in *Hill York:*

> [W]e must not be understood as even intimating that we can engage in the fact-finding process at the appellate level. 448 F.2d at 691.

The settlement in *Young v. Katz, supra,* provided that:

> The various defendants to the suit would pay plaintiffs' attorney fees in a fixed amount, subject to the approval of the court. *Id.* 447 F.2d at 434.

This was the precise arrangement in the instant case as well. However, the Panel was "convinced that the District Court fell into serious error when it approved the attorneys' fees proposed in the Bestline settlement." 610 F.2d at 1328. This conviction was based on the order entering final judgment which did not set forth fully the basis of the Court's finding "that the amount is reasonable under the circumstances of this protracted and complicated case." A,855. Although it is not apparent from the order, the record reveals that the District Court *did* "address the issue of attorneys' fees under the standards of *Johnson v. Georgia Highway Express,* 488 F.2d 714 (5th Cir. 1974)." 610 F.2d at 1328. However, the Panel ruled that "approval of the settlement must be reversed on this ground." 610 F.2d at 1328. This ruling appears in direct conflict with the consistent policy of this Court in cases where the record was insufficient to ascertain the basis for the trial judges' findings of fact and conclusions of law, to remand for the express purpose of enabling the District Court to state its findings, or when necessary to make further and more specific appropriate findings. *S.S. Silberblatt, Inc. v. United States,* 353 F.2d 545, 550 (5th Cir. 1965); *Shale v. United States,* 409 F.2d 412, 413 (5th Cir. 1969); *Bay Sound Transportation Co. v. United States,* 410 F.2d 505, 512 (5th Cir. 1969); *Davis v. United*

States, 422 F.2d 1139 (5th Cir. 1970); *Hodgson v. Brookhaven General Hospital,* 436 F.2d 719 (5th Cir. 1970); *Premier Corp v. Serrano,* 565 F.2d 1353 (5th Cir. 1977); *Complaint of Ithaca Corp.,* 582 F.2d 3, 4 (5th Cir. 1978).

As stated in *Cotton:*

> Particularly in class action suits, there is an overriding public interest in favor of settlement. 559 F.2d at 1331.

There is little doubt that the Panel's opinion will discourage settlement in complex class action suits. Added to the many existing obstacles discouraging embarcation on prolonged, tedious, expensive, time-consuming and often unrewarding complex litigation in the area of securities fraud class suits, discouragement of settlement will surely toll the death knell of a desired and needed social benefit. Thus, it would appear appropriate for the Court to grant a rehearing en banc.

CONCLUSION

For the foregoing reasons, Plaintiffs/Appelles, Peter Piambino, et al., respectfully request a rehearing of the within appeal by this Court sitting en banc.

CARL H. HOFFMAN

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that an original and one copy of the foregoing Petition for Rehearing was mailed or delivered to each attorney of record this_____day of May, 1980.

CARL H. HOFFMAN, P.A.
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2660 AmeriFirst Building
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BY:_____

APPENDIX D

In re BESTLINE PRODUCTS SECURITIES and Antitrust Litigation.

MDL No. 162-Civ-JLK.

United States District Court,
S. D. Florida.
March 19, 1976.

Action was brought by purchasers of direct distributorships of defendants' home and personal care products to recover for alleged violations of federal securities laws as well as for violations of various state Blue Sky Laws and for common law, fraud and deceit. Plaintiffs moved for summary judgment on issue of whether the distributorships were securities in the nature of investment contracts within ambit of the federal securities laws. The District Court, James Lawrence King, J., held that fact that class plaintiffs could not expect to receive a share of the proceeds from the common enterprise unless they contributed some effort was not inconsistent with existence of an investment contract and that the distributorships were investment contracts since they involved an investment of money or tender of initial value, relationship among the seller, distributors and others constituted a common enterprise and there was a reasonable expectation that an investment would lead to profits to be derived from significant or essential managerial or entrepreneurial efforts of others, which efforts affected the failure or success of the common enterprise or venture.

Interlocutory summary judgment entered.

1. Securities Regulation — 22, 43

Multilevel sales organization may be subject to the federal securities laws. Securities Act of 1933, §1 et seq., 15 U.S.C.A. §77a et seq.; Securities Exchange Act of 1934, §1 et seq., 15 U.S.C.A. §78a et seq.

2. Securities Regulation — 13, 42

Four essential elements must be found to be present in any economic relationship to give rise to the existence of an investment contract so as to bring such relationship into the ambit of federal securities regulation; such elements are: (1) An investment of money, or tender of initial value; (2) in a common enterprise or venture; (3) with a reasonable expectation of profits; (4) to be derived from the undeniably significant, or essential managerial or entrepreneurial efforts of others which affect the failure or success of the enterprise. Securities Act of 1933, §1 et seq., 15 U.S.C.A. §77a et seq.; Securities Exchange Act of 1934, §1 et seq., 15 U.S.C.A. §78a et seq.

3. Securities Regulation — 13, 42

Direct distributorships for sale or distribution to consuming public of line of personal and home care products were "investment contracts" within ambit of federal securities laws where the distributorship involved an investment of money or tender of initial value, i.e., prepurchase of substantial quantity of the product and sales aids, the relationship among the seller

of the distributorships, its corporate chain, distributors and others, constituted a common enterprise or venture and fortuity of the distributors' investment collectively was essentially dependent on the seller's expertise. Securities Act of 1933, §1 et seq., 15 U.S.C.A. §77a et seq.; Securities Exchange Act of 1934, §1 et seq., 15 U.S.C.A §78a et seq.

4. Federal Civil Procedure — 2543

In ruling on plaintiff's motion for summary jugment district court was to draw all reasonable inferences derivable from the facts favorably to the defendants. Fed. Rules Civ.Proc. rule 56, 28 U.S.C.A.

5. Securities Regulation — 13, 42

In determining whether direct distributorships of home and personal care products constituted "investment contracts" within ambit of federal securities laws, the business opportunity offered by participation as a distributor was to be viewed through the eyes of the class plaintiffs considering only such facts as were available to them at time of their individual investment decisions; essential inquiry in determining whether entrepreneurial efforts of others affected failure or success of the enterprise was plaintiffs' preinvestment expectations as to the nature of their investments and whether reasonable minds could differ as to such expectations. Securities Act of 1933, §1 et seq., 15 U.S.C.A. §77a et seq.; Securities Exchange Act of 1934, §1 et seq., 15 U.S.C.A. §78a et seq.

6. Securities Regulation — 13, 42

Fact that one does not expect to receive a share of proceeds from a common enterprise or venture unless he contributes some effort is not inconsistent with existence of an investment contract. Securities Act of 1933, §1 et seq., 15 U.S.C.A. §77a et seq.; Securities Exchange Act of 1934, §1 et seq., 15 U.S.C.A. §78a et seq.

James H. Joseph, Joseph & Hershman, P. C. Pittsburgh, Pa., Carl H. Hoffman, Miami, Fla., for plaintiff class.

J. Russell Pitto, Humphreys, Berger & Pitto, San Jose, Cal., for defendants Bestline Products, Inc., Bestline Corp., Jerry Brassfield, Oliver P. Colvin, James K. Hisler, Norman Miller and Richard Dumont.

Robert B. Hutchinson, Cotchett, Hutchinson & Dyer, San Mateo, Cal., Gerald F. Richman, Frates, Floyd, Pearson, Stewart, Proenza & Richman, Miami, Fla., for defendants William E. Bailey, Towru Ikeda and Martin Day.

Paul, Landy, Beily & Yacos, William M. Hoeveler, Knight, Peters, Hoeveler, Pickle, Niemoeller & Flynn, Miami, Fla., for defendants Richard Grillo, Janin Morgan & Brenner.

Marc W. Watson, Pettigrew & Bailey, Miami, Fla., for defendants Gordon Blaum, Edna Blaum and George Wunch.

OPINION AND ORDER DETERMINING MOTIONS FOR SUMMARY JUDGMENT

JAMES LAWRENCE KING, District Judge.

HISTORY OF THE LITIGATION

These proceedings constitute the third in a series of complex cases to be transferred by the Judicial Panel on Multidistrict Litigation to a single forum for coordinated or consolidated pretrial proceedings and which involve Federal securities law claims by alleged classes of private litigants against corporations claimed to have engaged in the offer and sale to the public of distributorships for their products, which distributorships are alleged to be unregistered securities in the nature of investment contracts or certificates of interest in profit-sharing arrangements.[1] Like its predecessors, these proceedings also involve alleged violations of the antifraud provisions of the Securities Act of 1933 (hereinafter "Securities Act" and the Securities Exchange Act of 1934 (hereinafter "Exchange

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[1]On December 15, 1972, approximately 20 private actions, followed by nearly 100 subsequent tag-along cases, which arose out of the offer and sale by Koscot Interplanetary, Inc. and Dare To Be Great, Inc., subsidiaries of Glenn W. Turner Enterprises, Inc., of multi-level distributorships were transferred pursuant to 28 U.S.C.A. §1407 to the Western District of Pennsylvania for consolidated or coordinated pretrail proceedings. On April 6, 1973, a dozen private actions followed by several dozen tag-along cases, arising out of the offer and sale of multi-level distributorships by Holiday Magic, Inc. and affiliated corporations were transferred to the Northern District of California for the same purpose. The Transfer Order in these proceedings was entered on April 29, 1974.

Act"), as well as violations of various state Blue Sky laws and common law fraud and deceit.

The instant proceedings arise out of the offer and sale by Bestline Products, Inc., a wholly-owned subsidiary of Bestline Corporation (hereinafter collectively referred to as "Bestline"), of pre-purchase Direct Distributorships contracts or agreements (hereinafter referred to as "Direct Distributorships") for the sale and distribution to the consuming public of its line of personal and home care products. Most of the individual actions consolidated in this judicial district assert that the Bestline Direct Distributorships are securities in the nature of investment contracts or certificates of interest in a profit-sharing arrangement, and that they were offered, sold and distributed unlawfully inasmuch as they were neither registered nor accompanied by a prospectus filed in compliance with the rules of the Securities & Exchange Commission.[2] Each such action seeks rescission of the distributorship agreements, as well as damages for fraud in connection with the sale thereof, and reasonable attorneys' fees. Some 40,000 persons are alleged to have purchased or invested in Bestline Direct Distributorships from late 1967 until August 10, 1973, in connection with which such persons paid Bestline an aggregate sum of nearly $120 million. Of those persons, less than 6,000 remain active as Bestline distributors.

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[2]The Defendants have never disputed that Bestline Direct Distributorships were unregistered, or that their offer, sale and distribution occurred by the means or instrumentalities of interstate commerce, including the mails. Admissions to that effect were made in response to the Piambino Plaintiffs' First Request For Admissions filed herein.

A multitude of Defendants are named in the numerous suits, most of whom are present or former officers, directors or controlling shareholders of Bestline, or persons who held the field (as distinguished from Home Office or Headquarters) positions of Assistant Vice President, Regional Director and Area Coordinator.[3] Bestline's officers, directors and controlling shareholders are alleged to have controlled and directed Bestline in its unlawful course of conduct, and together with its field representatives are also charged with aiding and abetting and participating in the alleged unlawful conduct by implementing the actual offer, sale and distribution of Bestline's Direct Distributorships throughout the country. In addition, various lawyers and a law firm which served as Bestline's General Counsel are charged with aiding and abetting the offer, sale and distribution of the Bestline Direct Distributorships, as well as the alleged fraud in connection therewith.

The original suit filed in this judicial district, and the lead suit in the consolidated proceedings, was brought by Florida residents Peter Piambino, Joseph F. Kucklick, Marilyn Koslen, Robert M. Ernst and Michael J. Gardner (hereinafter referred to as the "Piambino Plaintiffs") as a class action. On November 22, 1974, upon motion of the Piambino Plaintiffs, this Court ordered that the *Piambino* case should proceed as a class action on behalf of a class of Plaintiffs consisting of all persons who purchased or invested in Direct

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[3]Assistant Vice Presidents and Regional Directors, together with Home Office officials, constitute what in Bestline's parlance is referred to as its "Corporate Team".

Distributorship contracts or agreements, or their equivalents, who never qualified as General Distributors, and who have not re-ordered products from Bestline since May 22, 1974.[4]

By stipulation between the Piambino Plaintiffs and the Defendants, the latter of which sought to avoid having notice of the pendency of the class action sent to all 40,000 present and former distributors within the Plaintiff class because of the alleged disruptive effect it would have on Bestline's on-going business, a Notice of Pendency of Class Action was approved by this Court and sent by First Class mail only to those 10,000 members of the Plaintiff class who purchased or invested in Bestline Direct Distributorships after May 1, 1972, thereby embracing the calendar year preceding the earliest of those lawsuits transferred to this judicial district by the Judicial Panel on Multidistrict Litigation, and as to which persons the one-year limitation on actions contained in Securities Act §13

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[4]General Distributors were excluded from the Plaintiff class because, by definition, they were paid fees, bonuses, commissions or rewards for successfully recruiting Direct Distributors and may be alleged to be brokers or dealers with respect to the Bestline Direct Distributorships, thereby creating a possible conflict of interests within the Plaintiff class. Likewise, those Direct Distributors who repurchased Bestline products within six months preceding the class action order were excluded on the assumption that such persons remain active as distributors and may have an interest in Bestline's financial survival which conflicts with that of inactive Direct Distributors. Class members who previously received refunds or were part of a restitution plan arrived at in negotiations between Bestline and the Attorneys General of several states were excluded for obvious reasons.

does not apply. All class members whose Securities Act §12(1) claims were not thereby time-barred would be entitled to the remedy of rescission if this Court determined that the Bestline Direct Distributorships were securities, while the nearly 30,000 remaining class members would be relegated to claims arising out of alleged violations by the Defendants of the anti-fraud provisions of the Securities Act, the Exchange Act and the rules and regulations of the Securities & Exchange Commission, as to which claims this Court denied class status except insofar as they involve an adjudication of whether the Bestline Direct Distributorships are securities. It was also stipulated that upon any determination by this Court that the Bestline Direct distributorships constituted securities, the remaining portion of the Plaintiff class would be notified of such a ruling and would also be apprised of the effect thereof on their individual rights, including their right to initiate separate actions. In consideration of deferring notice to the remaining 30,000 class members until after any such ruling by this Court, the Defendants agreed to pay all costs of the deferred notice, while the Piambino Plaintiffs paid the cost of preparing and mailing the initial notice.

In March of 1975, this Court denied various Motions to Dismiss the class action which raised numberous objections to the Piambino Plaintiffs' Second Amended Complaint, as well as Motions For Summary Judgment filed by several Defendants.[5] This Court believed that the Motions For Summary

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[5]The disposition of the Motions to Dismiss and earlier Motions For Summary Judgment is reported at CCH Fed.Sec.L.Rep. ¶95,070 (S.D. Fla., March 21, 1975).

Judgment were at that time premature because of the then undeveloped state of the record.

Thereafter, the parties engaged in nearly twelve (12) months of extensive discovery. Thirteen separate sets of Interrogatories were propounded to the various Defendants and answered. Numberous Requests for Admissions and accompanying Interrogatories were served upon the Defendants and answered. Thirty-six Depositions on Oral Examination were taken which ran to in excess of 4,500 pages, virtually all of which were of Defendants in these proceedings during four week-long sessions in San Francisco and San Jose, California, Washington, D. C. and Miami, Florida. This member of the Court personally presided over nearly three weeks of said depositions with the permission of the Judicial Panel on Multidistrict Litigation in order to expedite the completion of discovery and eliminate countless motions by various parties to compel discovery. The Interrogatories, Request For Admissions and Depositions on Oral Examination of the parties and witnesses extended to the furthest reaches of Bestline's operation, as well as businesses subsequently organized or controlled by its present and former principals, and many former Corporate Team members.

Upon completion of the aforesaid discovery, the Piambino Plaintiffs moved this Court pursuant to F.R.Civ.P. 56 to enter partial summary judgment in favor of the Plaintiff class, and against the Defendants, on the sole issue of whether the Bestline Direct Distributorships are securities in the nature of investment contracts. Although the Piambino Plaintiffs have suggested several theories to reach the legal conclusion that the Direct Distributorships constituted

securities within the meaning of the Securities Act and the Exchange Act, the only theory pursued by them in support of their First Motion For Partial Summary Judgment is based in substantial part upon an application of the law expressed by the United States District Court for the District of Oregon in *Securities & Exchange Commission v. Glenn W. Turner Enterprises, Inc.*, 348 F.Supp. 766 (D.Or. 1972), *aff'd*, 474 F.2d 476 (9th Cir. 1973), *cert. denied*, 414 U.S. 821, 94 S.Ct. 117, 38 L.Ed.2d 53 (1974), followed by the Fifth Circuit Court of Appeals in *Securities & Exchange Commission v. Koscot Interplanetary, Inc.*, 497 F.2d 473 (5th Cir. 1974), and also followed by at least two District Courts in *Securities & Exchange Commission v. Bull Investment Group, Inc.*, CCH Fed.Sec.L.Rep. ¶95,010 (D.Mass., March 10, 1975), and *Securities & Exchange Commission v. JET Travel Services, Inc.*, CCH Fed.Sec.L.Rep. ¶95,317 (M.D.Fla., Aug. 29, 1975). All of the foregoing cases applied the Federal securities laws to multi-level sales organizations.

In response to the Piambino Plaintiffs' First Motion For Partial Summary Judgment, the principal Defendants joined in their own Motion For Partial Summary Judgment which sought dismissal of these proceedings on the limited grounds that because the Plaintiff class members received soap products from Bestline in consideration of their investment, as a matter of law no security can be found to exist.

The Piambino Plaintiffs contend that the Defendants' Motion For Partial Summary Judgment should be denied, and further submit that there is no genuine issue as to the material facts relevant to the entire issue of whether the Bestline Direct

Distributorships constitute securities in the nature of an investment contract within the meaning of the Securities Act and the Exchange Act, and that partial summary judgment on that issue should be entered by this Court in favor of the Plaintiff class, and against the Defendants. For the reasons hereinafter set forth, we agree.

APPLICABLE PRINCIPALS OF FEDERAL SECURITIES AND SUMMARY JUDGMENT LAW

[1] Since November 24, 1971, it has been clear that multi-level sales organizations may be subject to the Federal securities laws.[6] On that date, the Securities & Exchange Commission (herein referred to as "the Commission") issued its Release No. 5211, entitled "Applicability of the Securities Laws to Multi-Level Distributorship and Pyramid Sales Plans". 17 C.F.R. 231.5211. In that Release, the Commission advanced its view that the Federal securities laws may be applicable to certain multi-level sales organizations, and thereafter commenced several successful enforcement actions based upon that contention. *Securities & Exchange Commission v. Glenn W. Turner Enterprises, Inc.*, 348 F.Supp. 766 (D.Or. 1972), 474 F.2d 476 (9th Cir. 1973), *cert. denied*, 414 U.S. 821, 94 S.Ct. 117, 38 L.Ed.2d 53 (1974); *Securities & Exchange Commission v. Koscot Interplanetary, Inc.*, 497 F.2d 473 (5th Cir. 1974);

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[6]For an exhaustive discussion of the development of the applicability of securities laws to multi-level distributorships and pyramid sales plans, *see Pyramid Schemes: Dare To Be Regulated* 661 Geo.L.J. 1257 (1973).

Securities & Exchange Commission v. Bull Investment Group, Inc., CCH Fed.Sec.L.Rep. ¶95,010 (D.Mass., Mar. 10, 1975); and *Securities & Exchange Commission v. JET Travel Services, Inc.*, CCH Fed.Sec.L.Rep. ¶95,317 (M.D.Fla., Aug. 29, 1975).[7]

Before the decision of the United States District Court for the District of Oregon in *Securities & Exchange Commission v. Glenn W. Turner Enterprises, Inc., supra,* the leading and most-often cited authority for determining what forms of economic relationships constitute "investment contracts" within the meaning of the Federal securities laws was the decision of the Supreme Court in *Securities & Exchange Commission v. W. J. Howey Co.*, 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946). In its opinion in the *Howey* case, the Supreme Court stated that ". . . an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third-party . . . ." 328 U.S. at 298-299, 66 S.Ct. at 1103, 90 L.Ed. at 1249.

After the decision in *Howey,* the Commission, as well as the Courts which subsequently applied the law announced therein, expressed their recognition that the significant wording in the *Howey* definition of an investment contract was not the word "solely", but rather the word "efforts".

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[7]All of the reported decisions involved multi-level sales organizations.

The decision of the Oregon Court was the first to apply the reasoning that the word "solely" in the *Howey* decision did not relate to the *quantum* of the investor's efforts, but the relative *quality* of the efforts contributed by the investor and the promoter, or a third person. The reasoning of the Oregon Court was compelled by the *Howey* Court's earlier admonition that the definition of a security " . . . embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of money of others on the promise of profits." 328 U.S. at 299, 66 S.Ct. at 1103, 90 L.Ed. at 1250.

The Oregon Court accorded to the *Howey* test the degree of flexibility originally contemplated by the Supreme Court to effect the important remedial purposes of the Federal securities laws, without plying uncharted waters by adopting the approaches taken by several state courts in the application of their Blue Sky laws, or the reasoning of the Commission in Release No. 5211, which relied heavily upon such decisions.[8]

The effort of the Oregon Court to apply the *Howey* test to the Dare To Be Great multi-level sales scheme devised by Florida promoter Glenn W. Turner was subsequently affirmed by the Ninth Circuit Court of Appeals, and followed by the Fifth Circuit in *Securities & Exchange Commission v. Koscot Interplanetary, Inc., supra,* which reversed the decision of the United States

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[8]Likewise, the Supreme Court declined the invitation in *United Housing Foundation v. Forman,* 421 U.S. 837, 95 S.Ct. 2051, 44 L.Ed.2d 621, 43 U.S.L.W. 4792 (1975), to import the "risk capital" theory into Federal securities jurisprudence.

District Court for the Northern District of Georgia because that Court emphasized the *quantum* of the investor's efforts, rather than the relative *quality* thereof, in evaluating another Turner scheme. In affirming the decision of the Oregon Court, the Ninth Circuit Court of Appeals stated:

> We hold . . . that the definition of securities should be a flexible one, the word 'solely' should not be read as a strict or literal limitation on the definition of an investment contract, but rather must be construed realistically . . . .
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> * * * * * *
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> We adopt a more realistic test, whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise. 474 F.2d at 482.

And in reversing the Georgia Court, the Fifth Circuit held likewise. 497 F.2d at 485.

The direction charted by the Oregon Court, and followed by the Ninth and Fifth Circuits in elaborating upon the *Howey* test, received recent expression in *United Housing Foundation v. Forman*, 421 U.S. 837, 851-54, 95 S.Ct. 2051, 2060-61, 44 L.Ed.2d 621, 632-33, 43, U.S.L.W. 4742, 4747 (June 17, 1975), wherein the Court synthesized the law relating to investment contracts and restated the *Howey* principle in the following language: "The touchstone [of an investment

contract] is the presence of an investment in a common venture premised on a reasonable *expectation* of profits to be derived from the entrepreneurial or managerial efforts of others [Emphasis added]". By focusing on the *quality* of the efforts of others, the Supreme Court read the word "solely" out of the *Howey* test, it having become so much surplusage, thereby according to its prior *Howey* decision the flexibility originally intended.

[2] A review of the decisions of the District and Appellate Courts including the Supreme Court, in recent cases applying the *Howey*-generated test for an investment contract reveals four essential elements which must be found to be present in any economic relationship to give rise to the existence of an investment contract, thereby bringing such relationships into the ambit of Federal securities regulation. Those elements are: (1) An investment of money, or tender of initial value; (2) in a common enterprise or venture; (3) with a reasonable expectation of profits; (4) to be derived from the undeniably significant, or essential managerial or entrepreneurial efforts of others which affect the failure or success of the enterprise.

[3, 4] The Piambino Plaintiffs ask this Court to measure the material facts developed in these proceedings against a yardstick comprised of the foregoing elements on an investment contract. Based upon established principles of law applicable to summary judgments under F.R.Civ.P. 56, they insist, and we agree, that there is no genuine issue as to any material fact with respect to the issue of whether the Bestline Direct Distributorships constitute investment

contracts within the meaning of the Federal securities laws. *Poller v. Columbia Broadcasting System, Inc.*, 368 U.S. 464, 82 S.Ct. 486, 7 L.Ed.2d 458 (1962). In so doing, we draw all reasonable inferences derivable from such facts favorably to the Defendants. *United States v. Diebold, Inc.*, 369 U.S. 654, 82 S.Ct. 993, 8 L.Ed.2d 176 (1962).

In applying the applicable principles of the Federal securities laws and settled principles of summary judgment law to the facts involved in these proceedings, we note at the outset that virtually all of the facts of record herein are contained in a multitude of responses by the Defendants to discovery initiated by the Piambino Plaintiffs. There are no independent witnesses whose observations, knowledge or testimony is relied upon by the Piambino Plaintiffs in support of their First Motion For Partial Summary Judgment, and virtually all of the facts material to the so-called "securities issue" were elicited by the Piambino Plaintiffs from the Defendants themselves through reams of discovery documents, including lengthy depositions, which touched upon virtually every aspect of Bestline's business.

The mere extensiveness of the record, however, as well as the complexity of the facts and theories of law involved in these proceedings, have been heavily relied upon by the Defendants in opposing the Piambino Plaintiffs' First Motion For Partial Summary Judgment. The Defendants argue that there is a plethora of disputed facts which preclude this Court's determination of the securities issue by an interlocutory summary adjudication.

Despite the extensiveness of the record, the volume of facts contained therein, and the variety of far-reaching inferences which the parties urge this Court to draw therefrom, we have scrupulously limited this summary disposition of the securities issue to a consideration of only the *material* facts of record and the inferences which may be *reasonably* drawn therefrom, viewing all such facts and inferences in a light most favorable to the Defendants. By this strict and careful application of the standards required to be applied in summary adjudications, the facts and inferences to be considered to determine the Piambino Plaintiffs' First Motion For Partial Summary Judgment are dramatically reduced in number and scope.

Based upon our detailed review of the record in these proceedings, carried out in accordance with the foregoing principles applicable to summary adjudications, we hold that any specific factual controversies which are asserted in these proceedings involve facts which are immaterial to the issue of whether Bestline's Direct Distributorships constitute investment contracts, or the components of that issue as set forth hereinabove, either because any such facts are irrelevant to the issue before this Court or because they lack any uniformity of impact upon the class Plaintiffs. *Securities & Exchange Commission v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 478 (5th Cir. 1974).

With the foregoing principles of law in view, we hereby apply them to the material facts involved in these proceedings.

BESTLINE'S GROWTH AND DEVELOPMENT

Bestline's business began in August of 1966 when William E. Bailey and Jerry G. Brassfield (hereinafter referred to as "Bailey" and "Brassfield", respectively), two of the Defendants in these proceedings, joined forces to organize a multi-level direct sales organization to sell and distribute a line of bio-degradable soap products previously developed by one William Boudreau, a chemist. Prior thereto, Bailey and Brassfield had been associated as distributors for Holiday Magic, Inc., a multi-level direct sales company involved in the distribution of cosmetic products, which itself later became the object of numerous private and public suits and regulatory action.

Bailey and Brassfield had been involved in multi-level direct sales organizations prior to their Holiday Magic experience. Both had participated in the distribution of food supplements as part of the Nutri-Bio organization, and Bailey, together with William Penn Patrick, the founder of Holiday Magic, Inc., made an unsuccessful prior joint effort to establish a similar company in the corporate form of Ad-Mark, which later became insolvent.

Bestline was a successful venture from its inception. Led by Bailey and Brassfield, with the assistance of other persons who had multi-level direct selling experience, Bestline began the distribution of its line of bio-degradable soap products through a fledgling network of independent distributors who occupied various levels of its multi-level sales organization.

Bestline grew rapidly and in October of 1968, in order to share the ownership of the company with other loyal and devoted participants in its direct sales program, Bailey and Brassfield organized the Bestline Corporation and sold their interest in Bestline Products, Inc. to the new corporation for $10 million, also retaining majority ownership of that new company, while admitting others to minority ownership.

Until August of 1973, Bailey at all times remained the chief executive officer and Chairman of the Board of directors of Bestline, while Brassfield departed the organization in 1970, either as a result of a dispute over company policy or to seek greener pastures where he could achieve his own brand of independence. Bestline grew both in the number of distributors promoting and distributing its products, as well as geographically, and eventually was operating in all fifty states and several foreign countries.

During Bestline's growth and development, it attracted the attention of various law enforcement officials and regulatory agencies, including the Federal Trade Commission. Early in its history, Bestline entered into a consent decree with the Federal Trade Commission wherein it agreed to cease and desist from certain alleged unfair trade practices in connection with the recruitment of new distributors, and responded likewise to similar charges initiated by various state Attorneys General. As a result occasional changes were made in Bestline's multi-level sales program claimed to bring it into conformity with applicable state and Federal laws. Whether it successfully did so it is not within the province of this Court to determine, nor were

the changes made material to the issues in these proceedings.

In 1973, the Attorney General of the State of California obtained a civil judgment against Bestline, as well as certain individual Defendants herein, in the amount of $11 million arising out of violations by Bestline of California laws relating to deceptive trade practices. The company promptly filed an Original Petition under Chapter XI of the National Bankruptcy Act and sought the protection of the Federal Courts, but subsequently withdrew its petition after it successfully negotiated with the California Attorney General an arrangement to pay the $11 million judgment over a number of years, and after Brassfield effected a successful tender offer to acquire control of the company. In connection therewith, Bailey resigned and has remained retired from the business, while Bestline ostensibly eliminated the objectionable features of its multi-level direct sales plan and continues to do business through several thousand distributors.

Despite Bestline's travails, it grew to have some of the earmarks of a successful national business enterprise. Its initial meager line of cleaning agents and home care products expanded to 16 such products by March of 1972, six of which were manufactured in one or both of Bestline's manufacturing facilities in San Jose, California and Elk Grove Village, Illinois. Each such facility encloses in excess of 60,000 square feet, and the company rented or leased other regional distribution centers for its products. The remaining products were manufactured by others for Bestline in accordance with its specifications.

Bestline executives were transported throughout the United States on corporate aircraft and Corporate Team meetings sometimes took place on the company yacht, or at its ranch in northern California. Indeed, at its acme, Bestline's chief executive officer, William E. Bailey, recieved the Horatio Alger Award voted to successful entrepreneurs who exemplify the "American dream", which dream, coincidentally, Bestline claimed to offer to prospective distributors.

Bestline's officers' individual annual compensation ran into the hundreds of thousands, if not millions, of dollars, and Corporate Team members experienced annual earnings into six figures. By virtue of their earnings they were eligible to be inducted into either the "Chairman's Club", or the "President's Club", depending upon the magnitude of their success, as well as those of Bestline's distributors who qualified, and their status was constantly held out as an example to Bestline's network of independent distributors who were exhorted to do likewise. Such "success stories" were an essential element in Bestline's promotion of the business opportunity offered by participation in its National Marketing Plan.

THE BESTLINE NATIONAL MARKETING PLAN

Central to Bestline's success, as well as its past legal problems, was its "National Marketing Plan" which consisted of a network of independent distributors who functioned at various levels in its direct-sales organization.

For the most part, the Bestline National Marketing Plan was implemented through a heirarchy of three levels of independent distributors. Persons at the lowest or middle level were denominated "Local Distributors",[9] while those at the second or middle level were denominated "Direct Distributors". Those at the third and highest level of attainment were called "General Distributors". Neither the Local nor General Distributorships are involved in these preceedings. Any Bestline distributor could sell Bestline products anywhere in the United States, without limitation.

The Local Distributor was never required by Bestline to make any significant investment of money to procure his position and to exercise the rights attendant thereto.[10] The Local Distributor was eligible to sell Bestline products to the consuming public at retail prices and purchased them through his sponsoring Direct Distributor at a discount, the difference being his

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[9]Early in Bestline's history, the lowest level, later known as a Local Distributorship, was characterized by two levels successively denominated Sub-Distributor and Retailer. Ultimately recognizing that the two levels were not functionally unique, Bestline consolidated them into the single position of Local Distributor. Like the Local Distributorship, neither of its predecessors are involved in these proceedings.

[10]The Local Distributor qualified as such by paying $5 annual association dues. No product purchase was required.

or her commission.[11] He could also recruit other Local Distributors who could effect such sales for him

The Direct Distributor, on the other hand, was required to pre-purchase a substantial quantity of Bestline products and sales aids in order to qualify for his position and to exercise the rights attendant thereto.[12] Such rights included purchasing Bestline products, in some cases, at a greater discount than the Local Distributor,[13] as well as the right to "build an organization" of Local Distributors on whose selling efforts he could earn a profit. Of greatest significance to these proceedings, however, is the right vested in the Direct Distributor to recruit other Direct Distributors and thereby qualify to elevate himself to the position of

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[11]The Local Distributor's commission rate was progressive in nature, ranging from 30% to 50%, depending upon his personal sales during any calendar month. The Local Distributor received the 52% discount (the same as that enjoyed by a pre-purchase Direct Distributor) when his monthly sales exceeded $4,800. If he attained $5,600 in sales, the Local Distributor became a Direct Distributor, having "worked-in" to that position.

[12]The actual dollar amount required to be paid to Bestline varied from time to time, but averaged in excess of $3,000. The range of variations is immaterial to the fundamental issues involved in these proceedings.

[13]The Direct Distributor purchased Bestline products at a purported 52% discount rate.

General Distributor and to receive certain monetary bonuses or rewards in connection therewith.[14]

The General Distributorship could be attained only by those persons who first qualified as Direct Distributors and satisfied certain other requirements. The General Distributor had the right to purchase Bestline products at the greatest available discount,[15] and to "build an organization" of Direct Distributors and Local Distributors beneath him on whose selling and recruiting efforts he could earn a profit.

Despite the formality of their separate designations, Direct and General Distributorships are not fundamentally unique or discrete entities. Although they are separated by a differential of 8% in the respective rates of discount at which they purchase Bestline products, both Direct and General Distributors may sell directly to the consuming public, or through Local Distributors on whose selling efforts they can earn a profit. Yet the General Distributorship cannot be

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[14]In their Briefs, the Defendants criticize the Piambino Plaintiffs for assimilating the Direct and General Distributorships insofar as recruiting activities, and compensation therefor, are involved. However, both positions involved the recruitment of new Direct Distributors, the only difference being that the Direct Distributor who successfully recruited two new Direct Distributors received no remuneration therefor, because the two successive recruitments merely qualified him to become a General Distributor. Thereafter, successive recruitments accorded the distributor a direct pecuniary benefit.

[15]The General Distributor purchased products from Bestline at a purported 60% discount.

attained independently from a Direct Distributorship, i.e., a prospective distributor cannot enter the Bestline National Marketing Plan at its highest level. He must first become a Direct Distributor, even if only for a brief period of time. The fundamental difference in character between a General Distributor and a Direct Distributor is largely based upon the fact that General Distributors have successively recruited a requisite number of new Direct Distributors to qualify as such, while Direct Distributors have either not attempted to recruit new Direct Distributors in requisite number, or have been largely unsuccessful in any such attempts. In short, the General Distributorship is to the Direct Distributorship as a butterfly is to a caterpillar; the same being an advanced state of maturity or development of the other.

Until January of 1970, a Bestline Direct Distributor could qualify as a General Distributor by recruiting a new pre-purchase Direct Distributor to replace himself in his sponsoring General Distributor's "organization", and by paying to Bestline a $2,750 "release fee", ostensibly to release himself from his General Distributor's organization and to compensate that General Distributor for the loss of commissions which he would experience when the released Direct Distributor left the releasing General Distributor's organization to head his own organization as a new General Distributor. Bestline paid $2,250 of the $2,750 release fee to the rising Direct Distributor's former General Distributor who recruited or sponsored the released Direct Distributor in the first instance.

After January of 1970, the payment of release fees was discontinued, and the upwardly-mobile Direct Distributor could satisfy the requirements necessary to

rise to General Distributor by first recruiting a new Direct Distributor to replace himself in his sponsoring General Distributor's organization, by generating sales volume of $5,000 in a single month,[16] and paying a $600 fee to Bestline for attendance at a so-called "General Distributor's School". The additional requirements for advancement which replaced the release fee, however, fell far short of compensating for the income which the release fee had accorded General Distributors.

The establishment of the Special Incentive Bonus (SIB) plan responded to the need to fill the void left by the abandonment of the release fee. Special Incentive Bonuses were paid to General Distributors annually and were determined on a progressive basis by the annual sales volume in Bestline products for which the General Distributor was responsible, directly or indirectly. Because of its unique "profit-sharing" qualities (Bestline referred to it as a profit-sharing plan), the

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[16]The requisite sales volume could be generated by simply recruiting a second Direct Distributor for the sponsor's own organization, or by relying on either his own or his Local Distributors' retail sales, if any, or both. A later variation of the process of becoming a pre-purchase Direct Distributor involved the purchase of $500 of Bestline products directly from the Direct Distributor's sponsoring General Distributor, or his sponsor's sponsoring General Distributor if the sponsor is only a Direct Distributor, and the balance of the pre-purchase requirement from Bestline. Although no motivation is assigned to this variation, it made it possible for a pre-purchase Direct Distributor to dispose of his entire initial inventory in $500 increments to newly-recruited Direct Distributors (after the first two such recruitments qualified him as a General Distributor) thereby recouping his investment without ever having to sell Bestline products to the consuming public.

Special Incentive Bonus plan especially highlights the distinctive feature of the Bestline National Marketing Plan, which was, at every level, the payment of bonuses or commissions to distributors based upon "product movement" measured in "Refund Bonus Volume" (RBV), a fictitious value assigned to Bestline products upon which commissions and bonuses were computed.

Product movement effected by Local Distributors was necessarily between the Local Distributor and his customer. No commissions or bonuses were paid by Bestline to the Local Distributor. The Local Distributor purchased Bestline products from his sponsoring Direct Distributor at a discount, and could sell them at whatever price he chose, subject to contract restrictions, but without any real control by Bestline over the retail prices. Because Local Distributors make no initial investment, either in product or otherwise, this aspect of Bestline's National Marketing Program does not run afoul of the Federal securities laws, nor is it alleged by the Piambino Plaintiffs to offend those laws.

Product movement effected by Direct and General Distributors, however, is more complex. Inasmuch as Direct and General Distributors are exhorted to "build their organizations" by recruiting yet other distributors who pre-purchase substantial quantities of Bestline products, the commissions and bonuses paid in connection with the substantial product movement from Bestline into the hands of such new distributors constitutes remuneration for the recruitment of others into the Bestline National Marketing Plan. Although the concept of "product movement" obscured any distinction between the movement of Bestline products

into the hands of the consuming public as against movement into the hands of distributors, or among them, Bestline's parlance made a distinction between "retail" and "wholesale" business. Retail business involved precisely that, product movement into the hands of the consuming public. Wholesale business, on the other hand, involved product movement between distributors, or from Bestline into the hands of new distributors. The latter component of wholesale business, of course, was generated by recruitment of activities. Commissions and bonuses were paid on *all* product movement generated by Bestline distributors measured in RBV, without distinction between wholesale or retail business. By creating the fictions of "product movement" and "wholesale business", Bestline could state in its Business Opportunity Booklet provided to prospective distributors that "No compensation of any kind will be paid for the solicitation or recruitment of others". This self-serving declaration, however, relies upon those important terms to put a gloss on the underlying recruiting or "organization building" transactions which, in fact generated the "product movement" or "wholesale business" on which commissions and bonuses were paid.

Every Bestline distributor, at whatever level, had a "sponsor" to whose "organization" he was assigned, even if the sponsor resided hundreds or thousands of miles away. Each Direct Distributor Application required an identification of the applicant's "sponsoring" distributor for the purpose of paying commissions or bonuses on the product movement generated by his recruitment. Bestline thereby developed a complex system of accounting for the

responsibility for sponsorship of new distributors which was ultimately computerized, and the hard-copy output which recorded the payment of commissions and overrides on product movement through the chain of distributors was referred to in Bestline's parlance as "linkage reports". Bestline's computer also generated 3% and 8% "commission statements" to its distributors, from which data the company also paid the commissions set forth therein.

Upon review of the foregoing facts, all of which were elicited by the Piambino Plaintiffs from the Defendants themselves, this Court discerns four different methods by which Bestline distributors could profit from the recruitment of new distributors. Those four methods included: (1) the release fee; (2) the "standard" commission; (3) the "override" commission; and (4) the Special Incentive Bonus (SIB).

The release fee practice, which was abandoned in 1970, was the simplest method by which the Bestline investor profited from the recruitment aspect of the National Marketing Plan. As discussed previously, a rising Direct Distributor was required to pay a $2,750 fee to Bestline as a condition precedent to attaining the status of a General Distributor. Bestline retained $500 and paid $2,250 to the Direct Distributor's sponsoring General Distributor. By this technique, Bestline induced advancement from Direct Distributor to General Distributor. The "release fee", in effect, was a deferred method of compensating one distributor for sponsoring another distributor, subject only to the condition that the recruiting and the recruited distributors must ultimately become General Distributors.

Because of the differential in the rates of discount between General and Direct Distributors (60% and 52%, respectively), each sponsoring General Distributor was entitled to an 8% standard commission on "product movement" to or through each Direct Distributor sponsored by him, including the Direct Distributor's initial pre-purchase of Bestline products. The fact that the Direct Distributor may reside hundreds or thousands of miles away would not deprive his sponsoring General Distributor of his vested right to receive the 8% standard commission. In many cases, a new pre-purchase Direct Distributor would request that only half (or none) of an initial product inventory be shipped to him. In such cases, it made no difference as to the payment of the 8% standard commission on such product movement. The General Distributor was still entitled to receive the commission, and Bestline paid it, even though the products may never have physically moved at all.

In each case, Bestline accounted for all such transactions, received the funds and disbursed the commission payments to the beneficiaries of the program.

In addition to the 8% standard commission, Bestline offered and paid a 3% override commission to the sponsor of a sponsoring distributor, i.e., the distributor once-removed up the chain of distributors.[17] The sponsor of a sponsoring distributor was entitled to

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[17]The 3% override commission was discontinued by Bestline in 1972.

the 3% override commission solely by virtue of his initial sponsorship of the sponsoring distributor, even though he may have had no involvement in the subsequent recruitment. As with the 8% standard commission, the 3% override commission was paid whether the product was shipped or not.

The system of 3% override commissions was likewise administered by Bestline, and payments were remitted by the company on a monthly basis.

After the release fee feature of Bestline's National Marketing Plan was eliminated in 1970, the 8% standard commission differential and the 3% override commission remained as the sole inducement for the Direct Distributor to rise to the General Distributorship level. Bestline enhanced the attractiveness of advancing to the General Distributorship position by implementing the Special Incentive bonus (SIB) plan. The SIB was represented by Bestline to be a profit-sharing program.

SIB's were paid on an annual basis to qualifying distributors. The actual sum or sums of money paid was determined on a progressive scale as a percentage of product movement measured in RBV. The greater an individual distributor's annual RBV, the greater would be his annual SIB expressed as a percentage of the total annual RBV. Although annual RBV could consist of product movement through the distributor to the consuming public, it could also consist of product movement to newly-recruited distributors. No differentiation was made by Bestline, nor was any attempt made to measure the quantity of Bestline

products which actually flowed to the consuming public until the so-called "Cameo" program was developed in 1971 in response to criticism by regulatory agencies that the Bestline National Marketing Plan resulted in "garage loading" of its products in the possession of its distributors.

The average RBV generated by the recruitment of a new Direct Distributor, who later became a General Distributor, was about $15,000.[18] Whereas under the discontinued release fee program a General Distributor would be paid a 13% or $2,000 commission on a Direct Distributor who subsequently advanced to the General Distributor position, under the SIB program the General Distributor had to account for at least $36,000 RBV to be eligible for any commission at all. At that level, the General Distributor's commission would be 3.3% of his RBV. However, if the General Distributor successfully accounted for an annual RBV of $200,000, his commission rate would escalate to 15% of RBV, or $30,000. Thus, the General Distributor who recruited thirteen new Direct Distributors in any given calendar year would be in essentially the same position under the SIB plan as in the discontinued release fee program.

Of course, the new SIB plan had the disadvantage of making it necessary for the sponsoring General Distributor to recruit a greater number of Direct

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[18]The figure is attained by aggregating the RBV of each pre-purchase Direct Distributor's initial product purchase and the product movement, measured in RBV, generated by meeting all of the requirements for advancement to the position of General Distributor.

Distributors in order to receive the equivalent bonus expressed either as a percentage of RBV or in dollars, but it had the advantage of paying to a General Distributor a commission for the recruitment of a new Direct Distributor, even where the Direct Distributor subsequently failed to advance to the General Distributor level.

When the SIB plan is viewed in conjunction with the requirement that an advancing Direct Distributor recruit a new Direct Distributor to replace himself in his sponsor's "organization", it appears that his sponsoring General Distributor is credited with the RBV for the ensuing product movement, and that all such RBV is aggregated for the purpose of determining the sponsoring General Distributor's annual SIB. Hence, the General Distributor can qualify for and be paid an annual SIB based *solely* upon the recruiting efforts of Direct Distributors in his organization who seek to advance themselves to the position of General Distributors, and who thereby seek to be elligible for the "windfall" profits of the scheme.[19]

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[19]The illustration carries the proposition to an extreme conclusion. It is intended only to illustrate the point, and is not relied upon in making disposition of the securities issue herein by interlocutory summary adjudication. This Court has been scrupulous to avoid drawing any inferences from the material facts which assume that Bestline's product movement was generated primarily from recruitment, rather than retail sales, or vice versa. The actual relationship between these two aspects of Bestline's National Marketing Plan, insofar as the respective emphasis between them is concerned, is not a material issue herein.

In short, the abandonment of the release fee and the substitution of the SIB plan changed nothing except the form of the transaction. If anything, it removed from the conditions precedent to the payment of such bonuses any requirement that a General Distributor shepherd a newly-recruited Direct Distributor through the recruitments necessary to be accomplished by him to advance to the General Distributorship position, further eliminating, as a practical matter, any need for the General Distributor to exert any efforts at all.

Based upon the foregoing analysis of the facts, it is plain that the Direct and General Distributorships possess at least two attributes of the four which are necessary components of an investment contract. The Direct Distributor, through his pre-purchase of Bestline products, pays money to Bestline as a conditon precedent to his ultimate eligibility as a General Distributor to receive payments in the form of profit on his investment. It is also undisputed that Bestline managed the entire system of receiving, accounting for and disbursing such profits. Bestline's centralized administration of its network of independent distributors thereby also constitutes a significant element of the participation of its distributors in a "common enterprise or venture", or the third of the four necessary components of an investment contract.

In their countering Motion For Summary Judgment, the principal Defendants maintain that there is no genuine issue as to the fact that each pre-purchase Direct Distributor received soap products and sales aids in exchange for his or her investment in Bestline, but argue that upon that fact alone an

investment of money is negated. The moving Defendants thereby urge this Court to adopt a mechanical and simplistic notion of the Federal securities laws which prefers form over substance and ignores the economic realities of the transaction in Bestline Direct Distributorships.

Unquestionably, each member of the Plaintiff class paid money to Bestline in consideration not only of the quantity of Bestline products to be shipped to him (or reserved for him), but as a condition precedent to be eligible to act as a pre-purchase Direct Distributor, including the exercise of all rights and privileges attendant thereto. Whether the rights and privileges attendant to a Bestline Direct Distributorship piggy-backed with the product pre-purchased, or vice versa, is immaterial to the disposition of these proceedings. The fact is undisputed that in no way other than the pre-purchase of Bestline products[20] can a Plaintiff class member be eligible to exercise the rights and privileges

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[20]The possibility of a Local Distributor becoming a "work-in" Direct Distributor was discussed previously at Note 11, *infra*. For the purpose of this analysis, the pre-purchase and work-in methods of attaining Direct Distributorship status are indistinct. Work-in Direct Distributors are not members of the Plaintiff class by definition. The former qualified by expending either his own or borrowed funds to pre-purchase Bestline products in required quantity, while the latter pre-sells in a single calendar month essentially the same volume of Bestline products required to be pre-purchased by the former. The point made is that the rights and privileges of a Direct Distributorship were not offered by Bestline separate and apart from the specified volume of product movement, however, created. Such rights were neither "given away", nor sold for a separate consideration.

which vest in a Bestline Direct Distributor. Those rights, and the eligibility of the Plaintiff class members to exercise them, are a basic and fundamental part of the consideration for the transaction which forms the economic relationship between Bestline and the investor. Clearly, the Plaintiff class members did not purchase thousands of dollars in Bestline products for their own use or consumption, but for re-distribution to either the consuming public or other distributors, or simply to store in their garages while they devoted their time to "building their organizations", which, in Bestline's parlance, meant the recruitment of other distributors.

For the foregoing reasons, we hold that the transaction between Bestline and the Plaintiff class members involved an investment of money, or tender of initial value, and deny the principal Defendants' Motion For Summary Judgment on that issue.

IMPLEMENTATION OF THE BESTLINE NATIONAL MARKETING PLAN

Bestline's field organization, and its function, like its centralized administrative or clearing-house services, is an integral part of its National Marketing Plan.

Shortly after its inception, as its recruitment of new distributors grew both numerically and geographically, Bestline assembled a field organization to continue and further expand its business. There eventually developed a hierarchy of field positions responsible to the Vice President in charge of sales in the Home Office or corporate headquarters at San Jose, California.

Immediately under the Vice President, and directly responsible to him, Bestline established the position of Assistant Vice President. There were six Assistant Vice Presidents who were assigned specific geographic territories to supervise, usually consisting of seven to nine states. Immediately beneath the Assistant Vice Presidents in rank, Bestline established the position of Regional Director, while persons were also assigned specific smaller geographic territories to supervise, usually consisting of a single state or part thereof. And beneath the Regional Director in responsibility, Bestline created the position of Area Coordinator, and sometimes Assistant Area Coordinator. Each Area Coordinator reported to a Regional Director, and was assigned to a specific geographic territory to supervise, usually consisting of several smaller medium-sized cities, or parts of large ones. Their duties included organizing and presenting Opportunity Meetings, conducting training sessions for distributors, supplying data to Bestline's Home Office for its Corporate Calendar and coordinating and effectuating company policy in the field. Assistant Vice Presidents and Regional Directors were appointed and paid by Bestline, although they could also continue to perform as distributors if they so desired, and some did. Area Coordinators were appointed by Bestline and paid through its Regional Directors. The method of compensation of Bestline's field representatives changed from time to time, but always included in substantial part a commission based upon "product movement" within their assigned areas, which, of course, included the movement of Bestline products pre-purchased by newly-recruited Direct Distributors.

Key Home Office officials, Assistant Vice Presidents and Regional Directors, but not Area Coordinators, came to be known as members of Bestline's "Corporate Team". Corporate Team meetings were held monthly in a single location in the United States, at which Home Office officials, and sometimes legal counsel, reviewed existing company policies with respect to the National Marketing Plan, announced new policies, admonished the Corporate Team to enforce all policies and generally motivated each other. A consistent theme in Corporate Team meetings was enforcing adherence to scripts provided by Bestline for use at Opportunity Meetings to which distributors invited guests to become acquainted with the Bestline business opportunity as part of the exhorted goal of each distributor to "build his organization", as well as adherence to the recommended procedures by which prospects were introduced to Bestline and its network of distributors, whether through the device of "Opportunity Meetings" or otherwise.

Like Koscot and Dare To Be Great,[21] a key feature of the Bestline National Marketing Plan was the "Opportunity Meeting" which consisted of a gathering of Bestline distributors and prospective distributors in a hotel or motel meeting room, or any other suitable meeting-place. The purpose and effect of the Opportunity Meeting was the creation of an effective vehicle by which distributors could "build their organizations" by inviting prospective distributors to

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[21] *Securities & Exchange Commission v. Koscot Interplanetary, Inc., supra; Securities & Exchange Commission v. Glenn W. Turner Enterprises Inc., supra.*

receive a standardized presentation or introduction to Bestline's products and business opportunity. Although the Opportunity Meetings may not have been the exclusive vehicle utilized to introduce Bestline to prospective distributors, it was by far the overwhelmingly dominant method, the one recommended by the company, and the most effective, even though it had to be supplemented by the efforts of individual distributors to consummate sales of new Direct Distributorships in accordance with guidelines promulgated by Bestline.

Dozens, if not hundreds, of Opportunity Meetings were conducted almost daily throughout the United States. The time and place of each Opportunity Meeting was relayed to Bestline's Home Office through its Corporate Team and assembled into a single regularly-published and distributed "Corporate Calendar" for use by its distributors. By means of this vast network of standardized Opportunity Meetings, an Omaha distributor could (and was encouraged to) "build his organization" by referring friends in Seattle or Miami to a convenient Opportunity Meeting in their locale. And if the New York or Miami friend became a pre-purchase Direct Distributor he was assigned to his sponsor's organization in Omaha, which sponsor would receive the standard commission paid by Bestline on the product movement from Bestline to the newly-recruited distributor.

To insure uniformity at each of the thousands of Opportunity Meetings, Bestline distributed scripts for speakers to use at such meetings, as well as records, film strips and a Bestline Business Opportunity Booklet to

be delivered to each prospective distributor. Assistant Vice Presidents, Regional Directors and Area Coordinators frequently conducted the Opportunity Meetings, or at least attended them to insure adherence to company policy. Bestline even employed a firm of private detectives to report to it as to the adherence to company policy at Opportunity Meetings, and frequently required electronic recording of such meetings for review by legal counsel.

In some areas the meetings were organized and paid for by local "cooperatives" of distributors, usually with the assistance of an Area Coordinator or Corporate Team member. Co-op members paid dues which were in turn allocated to the expense of conducting Opportunity Meetings. A distributor who did not join the co-op, or whose dues were not current, as a practical matter, could still attend and bring a prospect for "his organization", but in some areas, at least, he would be warned not to come back a second time if he was not a member in good standing of the cooperative.

There is no genuine issue that the relationship among Bestline, its Corporate Team members and Area Coordinators, the cooperatives and the Bestline distributors constituted a common enterprise or venture, whether for the sale and distribution of Bestline products to the consuming public, or for the recruitment of new distributors, and we so hold.

THE INVESTORS' EXPECTATIONS

The pressure point of the application of the principles of Federal securities and summary judgment law to the facts of these proceedings involves the "reasonable expectations" of the class Plaintiffs with respect to their investment in Bestline Direct Distributorships, including the locus of the undeniably significant or essential managerial or entrepreneurial efforts resulting in the payment to them of a share of the profits to be derived from the common enterprise or venture.

The Defendants have strenuously argued that the facts elicited from them in pretrial discovery unquestionably reveal that the individual investor is the locus of the undeniably significant or essential managerial or entrepreneurial efforts necessary to the success of the Bestline National Marketing Plan, and to their individual financial success. They also contend that no reasonable investor could expect or conclude otherwise, thereby removing the Bestline National Marketing Plan from the ambit of the Federal securities laws. The Piambino Plaintiffs, on the other hand, suggest that the undeniably significant or essential managerial or entrepreneurial efforts required in connection with the success of the Bestline National Marketing Plan repose in Bestline and its Corporate Team members, including Area Coordinators. In support of their respective arguments, all of the parties rely upon the extensive factual record relating to the pre-investment presentations made to the class Plaintiffs, as well as to the actual operation of the Bestline National Marketing Plan viewed from a post-

investment standpoint, including a variety of inferences derived therefrom.

[5] The parties' reliance upon this broad range of facts, however, is misplaced and creates a false or illusory issue in these proceedings. It is not necessary to a determination of the class Plaintiffs' expectations for this Court to consider such a broad range of facts and inferences. The elemental inquiry is the class Plaintiffs' *pre-investment* expectations as to the nature of their investments in Bestline Direct Distributorships, and whether reasonable minds can differ as to such expectations.[22] In short, the business opportunity offered by participation as a distributor in Bestline's National Marketing Plan must be viewed through the eyes of the class Plaintiffs, considering only such facts as were available to them before they made their individual investment decisions.

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[22]Although these proceedings also involve extensive allegations of misrepresentations and omissions of material facts in the standardized presentations of Bestline's business opportunity to prospective investors, the Piambino Plaintiffs First Motion For Partial Summary Judgment does not require this Court to determine those issues. The existance of such misrepresentations and omissions, however, may in no small measure account for the diametrically opposed factual contentions of the parties with respect to the operation of the Bestline National Marketing Plan from a post-investment viewpoint. The Defendants rely heavily upon their view of how the Bestline National Marketing Plan operated, rather than how it was presented to the prospective investors. This inquiry is necessarily limited to the pre-investment presentations made to the Plaintiff class, because it was from those presentations that the class Plaintiffs derived their expectations with respect to their investment in Bestline Direct Distributorships.

In this regard, it is only necessary that this Court review the facts as to the mode and manner of interesting class Plaintiffs in the business opportunity offered by participation in Bestline's National Marketing Plan, and of presenting that business opportunity to them, whether at Opportunity Meetings or otherwise. In so doing, this Court looks not only to the economic substance of the transactions in Bestline Direct Distributorships, but equally to ". . . what character the instrument is given . . . by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect. In the enforcement of an act such as this [Securities Act], it is not inappropriate that promoters' offerings be judged as what they were represented to be". *Securities & Exchange Commission v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 352-353, 64 S.Ct. 120, 124, 88 L.Ed. 88, 94 (1943) [quoted approvingly in *Securities & Exchange Commission v. United Benefit Life Insurance Co.*, 387 U.S. 202, 211, 87 S.Ct. 1557, 1562, 18 L.Ed.2d 673, 679-80 (1967)]. In their joint brief, the Defendants accede to the propriety of the foregoing approach and have urged this Court to adopt a narrow scope of inquiry limited to the various forms of Direct Distributorship agreements, Direct Distributorship qualification forms, the Bestline Business Opportunity Booklet, the Opportunity Meeting scripts, and product and marketing films. Such a limitation is appropriate, and this Court has restricted itself to an analysis of those documents and things with respect to this aspect of the securities issue, notwithstanding arguments advanced by all parties to these proceedings based upon a broader range of facts which, for the foregoing reasons, are immaterial to the issue.

By circumscribing the inquiry as aforesaid, and confining it to the review of such material documents and things, we find that there is no genuine issue as to the fact of what representations were made to prospective Bestline distributors through standardized presentations based thereon, whether at formal or informal meetings, or otherwise, although there is some dispute as to random or spurious representations made to the named Plaintiffs by other Bestline distributors and Corporate Team members outside the context of Bestline's standardized presentations. In reaching this conclusion, however, we have regarded as immaterial to this summary adjudication of the securities issue any testimony of the named Plaintiffs which is based upon such random or spurious representations because such representations lack any uniformity of impact on the class Plaintiffs and also because in view of our finding, they are surplusage. Such representations merely reinforce expectations otherwise effectively created in the minds of the reasonable investor by the standardized pre-investment presentations.

There is no genuine dispute as to the fact that the class Plaintiffs, as well as thousands of others, were indiscriminately solicited to be exposed to the Bestline business opportunity, without regard to their backgrounds, education, training or individual abilities. The Defendants concede as much, and suggest merely that the quality of Bestline's training program adequately compensated for any lack of relevant experience or education, and that "a person's desire to succeed and willingness to work far exceed any

educational or business background prior to Bestline."[23] These persons, drawn "from all walks of life, ethnic backgrounds, with varied educations, experience, ages and religions",[24] were then introduced to Bestline's business opportunity, either through the device of an Opportunity Meeting, or some other formal or informal presentation based upon guidelines promulgated by Bestline in its Information Manual, from which presentations they derived their expectations as to the character of an investment in Bestline Direct Distributorships.

The fact that some Bestline distributors may have obtained "prospects" by advertising in "Help Wanted" columns of local newspapers, by direct mail, or by striking up conversations on street corners, or that they may have intentionally refused to explain the Bestline business opportunity on such first contacts to heighten the prospective investor's "curiosity", may betray the motives of the Defendants in connection with the class Plaintiffs' fraud claims, but the use of such techniques are not basic to a determination by this Court as to the expectations created in the minds of the class Plaintiffs as to the character of their investments in Bestline Direct Distributorships. Similarly, zealousness at Opportunity Meetings evidenced by out-pourings of enthusiasm, speakers running or hurrying to the rostrum, exuberant applause, chanting or singing, and other conduct of a similar nature, may also bear upon

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[23]Bestline Business Opportunity Booklet (all editions), p. 7.

[24]This phrase, in several variations, appears in all editions of the Bestline Business Opportunity Booklet, as well as several times in each Opportunity Meeting script.

the Piambino-Plaintiffs' allegations of fraud and high-pressure salesmanship, but are immaterial to the basic inquiry involved in this adjudication, thereby differentiating it somewhat from the decision of the *Koscot* and *Turner* Courts, which involved important fraud questions. The elucidation in those decisions of the high-pressure sales tactics of the promoters was directed to the Commission's claims of violations of the antifraud provisions of the Federal securities laws. In contrast, this Court is called upon only to resolve the limited issue of whether there is any genuine controversy as to the fact that Bestline's pre-investment standardized presentations, in their material aspects, created in the class Plaintiffs' minds the reasonable expectation that an investment in Bestline Direct Distributorships would lead to profits to be derived from the undeniably significant or essential managerial or entrepreneurial efforts of others which affect the failure or success of the common enterprise or venture.

The apparent lack of sophistication of the class Plaintiffs herein contrasts sharply with the decisions of other Courts which have held that specific franchise agreements involved therein were not investment contracts within the meaning of the Federal securities laws, and compares favorably with the decisions of those Courts which have found otherwise. *See e.g., Mr. Steak, Inc. v. River City Steak, Inc.*, 324 F.Supp. 64 (D.Colo., 1970), *aff'd*, 460 F.2d 666 (10th Cir. 1972) (River City Steak was not an uninformed investor, but was acquainted with the business it undertook, held not to involve the offer and sale of an investment contract); *Beefy Trail, Inc. v. Beefy King International, Inc.*, 348 F.Supp. 799 (M.D. Fla.1972) (controlling stockholder of

Beefy Trail had extensive background as a businessman having owned and managed a retail department store, had an interest in a construction business, together with his attorney spent a considerable period of time negotiating with Beefy King over the terms and conditions of the ultimate purchase of a restaurant and franchise wherein some of the documents were drafted by his attorney, and was employed as a consultant to Beefy King actually working daily in its offices for a period of time, held not to involve the offer and sale of investment contract). In evaluating the impact of the promoter's offering on the expectations of the investor, the investor's experience, training and abilities have always been considered an important starting point. In some cases it has been the dispositive issue. In these proceedings, we find that the Bestline National Marketing Plan was a highly-organized nationwide program addressed to the population at large, without discrimination or qualification as to the sophistication of the prospective investors.

There is no question that Bestline's National Marketing Plan held out to such investors the expectation of profits to be derived from participation therein. The lure of profits permeates Bestline's meeting scripts, literature and film strips which comprise its standardized presentations to prospects for its distributorships. Even a cursory review of those materials reveals that an expectation of profits was not only reasonably derivable therefrom, but that those materials exclude any other reasonable expectation. We are therefore constrained to conclude that there is no genuine issue as to the fact that the class Plaintiffs were led to expect that profits would be derived from an

investment in Bestline Direct Distributorships, and that no reasonable investor could possibly conclude otherwise. In view of this finding, the disposition issue involves the reasonable investor's expectations as to the relative quality of the efforts to be contributed to the common enterprise or venture in order for him to receive a share of the proceeds therefrom.

In resolving this crucial issue, it is important to note that Bestline's Direct Distributorships are fundamentally unlike traditional business franchises. In a typical business franchise the franchisee acquires a bundle of legal rights, frequently including the right to employ in a specific geographic area, a business system developed by the franchisor, as well as intangible proprietary rights involving trade secrets, trade names, trademarks and, possibly, patents. Few franchisors require their franchisees to purchase goods or services from the franchisor or a designated supplier in connection with the franchisee's operation of the franchised business. Although it is possible for an instrument identified as a franchise to infringe upon the Federal securities laws, traditional business franchises have been generally held to be beyond the pale of securities regulation because the franchisee's unit of what is usually a common enterprise is largely independent of the success or failure of the franchisor, or other franchisees, although the franchisor's failure or success may increase the risk undertaken by the franchisee. In short, in most cases involving allegations that a business franchise constituted an investment contract, it has been held that the franchisee's risk is not sufficiently integrated with that of the franchisor to

bring such franchises within the scope of the Federal securities laws.[25]

Although distributorships may involve the acquisition by the distributor of many of the same rights involved in the traditional business franchise, distributorships generally involve rights respecting a specific product or product line manufactured or produced by or on behalf of the offering entity. The nature of the product and its distribution may require the distributor to establish and operate a separate or independently integrated business to sell the product to the distributor's customers, and to service the product, if necessary. Other distributorships may require an established place of business, but may not involve a product which requires the distributor to exercise a service function. Yet other distributorships may not require either an established place of business, or a product which involves the distributor in a service function.

The failure of the manufacturer or producer of a product subject of a distributorship may or may not destroy the distributor as an independently viable business entity. Depending upon the nature of the product involved, the distributor's business may not be destroyed if it otherwise involves the sale of other products, or if it is easily adaptable to the sale of other products. On the other hand, if the product involved is the sole product sold by the distributor, and if his whole

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[25]This is not to say, however, that some franchises may not fall within the scope of the Federal securities laws because they lack other essential features of an investment contract, i.e., an investment of money or participation in a common enterprise.

method of operation is inherently related to that product, the distributor's business will certainly perish in the face of the manufacturer or producer's failure. In either event, the distributorship itself is rendered worthless.

Bestline's Direct Distributorships involve a high degree of dependency upon the success of the company, or integrated risk. Without regard to the issue of Bestline's participation in the recruitment of new distributors, the company's standardized presentations lead to the inevitable expectation by the class Plaintiffs that it has developed, manufactures and successfully promotes a line of quality home and personal care products, and that it will continue to do so for the foreseeable future. An essential part of the investor's expectations is that the company will provide continuing assistance to its distributors, and will administer the system by which commission or bonuses are paid to its distributors in accordance with the representations contained in its standardized meeting scripts, literature and film strips. No other interpretation of those materials is reasonable.

The class Plaintiffs are not manufacturers or producers of soap, and the terms and conditions of their participation in the Bestline National Marketing Plan are controlled by Bestline. They expected not merely to sell soap, but to participate in the National Marketing Plan. If they had sought merely to sell soap, a Local Distributorship, which involved no investment, would have done nicely.

Although the class Plaintiffs risk may not be totally integrated with that of Bestline, the nature of the integration is such that Bestline's failure would not only render its distributorships worthless, but would effectively put the distributor out of business as a separate or independent entity. He may be able to liquidate his inventory of soap products then on hand, but mere inventory liquidation is neither business survival nor what the authorities contemplate as the kind of managerial or entrepreneurial efforts which affect the failure or success of the enterprise or venture.

We therefore hold that the nature of the relationship between Bestline and the class Plaintiffs, as it is explained to prospective investors in the company's standardized presentations, is such that compels the reasonable expectation that Bestline had in the past, and would continue for the foreseeable future, to supply the managerial or entrepreneurial talents, skills and experience essential to the continuing development, manufacture and promotion of a salable line of home and personal care products, and to the management of its multi-level network of distributors as part of its National Marketing Plan, and that those efforts reasonably expected by the class Plaintiffs are the essence of the success of the common enterprise or venture from which they expected to derive their share of the proceeds. Reasonable minds cannot differ as to that expectation; it is compelled by Bestline's standardized presentations to the exclusion of any other reasonable expectation.

The sole remaining issue dispositive of the Piambino Plaintiffs' First Motion For Partial Summary

Judgment is whether the class Plaintiffs reasonably expected to themselves contribute any essential managerial or entrepreneurial efforts to derive their share of the proceeds from the common enterprise or venture.

There is no question that the class Plaintiffs expected to contribute some efforts, in addition to their money, to receive their share of the proceeds from the successful operation of Bestline's National Marketing Plan. None of them expected "something for nothing". Many expected to "work hard", and some personally expected to sell Bestline products at retail. All of these expectations are reasonable inferences to be drawn from Bestline's standardized presentations. All of them, however, beg the question as to whether the class Plaintiffs reasonably expected to themselves contribute the undeniably significant, or essential managerial or entrepreneurial efforts which affect the failure or success of the common enterprise or venture.

[6] The fact that the class Plaintiffs could not expect to receive their share of the proceeds from the common enterprise or venture unless they contributed some efforts is not inconsistent with the existence of an investment contract. In this respect, the Ninth Circuit Court's review of the *Howey* decision in *Securities & Exchange Commission v. Glenn W. Turner Enterprises, Inc., supra,* is instructive. In that decision, the Court remarked: "Let us assume that in *Howey, supra,* the sale and service agreements had provided that the buyer was to buy and plant the citrus trees. Unless he did so, there would be no crop to cultivate, harvest and sell, no moneys in which he could share. The essential nature of

the scheme, however, would be the same. He would still be buying, in exchange for money, trees and planting, a share in what he hoped would be the company's success in cultivating the trees and harvesting and marketing the crop. We cannot believe that the Court would not have held such a scheme to be an investment contract." 474 F.2d at 482. The fact that the distributor's efforts may be necessary to the success or failure of the common enterprise or venture, or the individual distributor's unit thereof, does not, however, establish the quality of those efforts. Every retail merchandising outlet, for example, requires the efforts of sales personnel to achieve success, as well as secretaries, bookkeepers and a garden-variety of additional personnel customarily associated with the operation of a business enterprise. The fact that the efforts of such persons are necessary, however, does not establish that those efforts are managerial or entrepreneurial in nature, or sufficient to significantly affect the failure or success of the enterprise or venture.

The crux of the decision in *Securities & Exchange Commission v. Glenn W. Turner Enterprises, Inc., supra,* is that if the efforts contributed by the investor are not "those essential managerial [or entrepreneurial] efforts which affect the failure or success of the enterprise", the efforts themselves rise to no higher status than an investment, different from money only in kind. The absence of any managerial or entrepreneurial skills or abilities from the efforts required of investors in the Dare To Be Great scheme compelled the Ninth Circuit Court to conclude that the participants in the scheme were sold the idea that they would get a fixed share in the proceeds from the sale of "Adventure" plans, and that " . . . to get that share, he invests three

things: his money, his efforts to find prospects and bring them to the meetings, and whatever it costs him to create an illusuion of his own affluence". 474 F.2d at 482. The *Turner* Court held that the Dare To Be Great investors' efforts did not rise in quality to the level of essential managerial or entrepreneurial efforts which affect the success or failure of the common enterprise, and thereby consisted of nothing more than a further investment to receive a fixed share of the proceeds from the efforts of Dare To Be Great. The efforts which the class Plaintiffs in these proceedings reasonably expected to contribute to the Bestline National Marketing Plan rises to no higher status.

Every class Plaintiff, with minor exceptions, became a Direct Distributor in Bestline's National Marketing Plan based upon a reading of the Bestline Business Opportunity Booklet, standardized Opportunity Meeting scripts (or variations employed by individual distributors), testimonials of "successful" distributors, and film strips. After 1970, Direct Distributorship qualification forms required the class Plaintiffs to affirmatively respond to the inquiries whether they had attended an Opportunity Meeting and whether they had received and read the Bestline Business Opportunity Booklet as a condition precedent to their eligibility to become Direct Distributors.

Although we are not here involved with a disposition of the class Plaintiffs' fraud claims, it appears from a thorough review of the foregoing documents and things, including the Bestline Information Manual which contains guidelines for distributors to respond to questions asked by

prospective distributors, that precious little information of any substance was provided to the class Plaintiffs upon which they could determine what efforts, if any, they would have to contribute to derive their share of the profits from the operation of Bestline's National Marketing Plan.

The class Plaintiffs necessarily begin their evaluation of the facts provided in Bestline's standardized presentations upon the expectation that people from all walks of life, with different educations, backgrounds and experience, have become successful in Bestline. This theme was predominant in Bestline's standardized presentations. This clear expectation rules out any other expectation that individual class Plaintiffs must bring with them to Bestline any special or unique experience or ability, but that only a strong desire to succeed financially and a willingness to work hard toward that goal would be necessary.

The class Plaintiffs are, however, told that they will receive valuable training from Bestline. But they are given no details as to the substance of such training. They must inevitably expect to completely rely upon any such training to derive their share of the proceeds from the Bestline National Marketing Plan.

The class Plaintiffs could not reasonably expect that their efforts would involve predominantly the retail sale of Bestline products, for that is clearly stated in Bestline's standardized presentations to be the main job of Local Distributors. They likewise could not expect to operate a place of business and employ administrative personnel in connection therewith, or to keep customary

business records, for they are specifically told in Bestline's standardized presentations that a Bestline Direct Distributor has very low overhead, consisting only of co-op dues, freight and a garage or basement to warehouse their Bestline product inventory. Although prospective distributors are told of "hard work" and "great effort" required of them, the substantive representations contained in Bestline's standardized presentation de-emphasize the significance of such efforts and stress the training, assistance and guidance which they will receive from Bestline in becoming successful distributors, and how they will work together with Bestline and other distributors to so succeed.

Upon a complete review of the totality of the standardized presentations of the Bestline Business Opportunity to the class Plaintiffs, and the representations contained therein, we find that reasonable minds cannot differ in the expectation compelled thereby that the ovewhelmingly dominant feature of an investment in Bestline's Direct Distributorships was the recruitment of other participants in the Bestline National Marketing Plan. Virtually every example contained in such materials relating to the high incomes that could be obtained as a Bestline distributor relied upon recruitment of other participants, whether accomplished through the device of Opportunity Meetings or at other formal or informal presentations.

In view of these findings, we hold that the fortuity of the class Plaintiffs' investments collectively is essentially dependent upon Bestline's expertise. Lacking the business acumen possessed by Bestline and

its Corporate Team, the class Plaintiffs inexorably rely upon Bestline's guidance for the success of their investment. "This guidance, like the efficacy of Koscot meetings and guidelines on recruiting prospects and consummating a sale, is uniformly extended to all investors. That it may bear more productive fruits in the case of some [distributors] than it does in cases of others should not vitiate the essential fact that the success of the [National Marketing Plan] as a whole and customer investments individually is contingent upon the sagacious [management of the National Marketing Plan by Bestline and its Corporate Team]". *Securities & Exchange Commission v. Continental Commodities Corp.*, 497 F.2d 516 (5th Cir. 1974).

CONCLUSION

Based upon the review of the voluminous, complete and ample record in these proceedings, including interrogatories and answers thereto, admissions and depositions of parties, this Court concludes that there is no genuine issue as to any material fact bearing on the question of whether the Bestline Direct Distributorships offered and sold to the Plaintiff class from August 16, 1966 to August 10, 1973 were investment contracts within the meaning of the Federal securities laws, and that said distributorships were unregistered in form and offered, sold and distributed to members of the Plaintiff class by the means and instrumentalities of interstate commerce, including the mails, and as a matter of law the class of Plaintiffs is entitled to an interlocutory adjudication with respect thereto.

APPENDIX E

Peter PIAMBINO et al.,
Plaintiffs-Appellees,

v.

William E. BAILEY et al.,
Defendants,

Bestline Products, Inc., a California Corporation et al.,
Defendants-Appellants.

In re BESTLINE PRODUCTS SECURITIES AND ANTITRUST LITIGATION.

Peter PIAMBINO et al.,
Plaintiffs-Appellees,

v.

William E. BAILEY et al.,
Defendants,

David SYLVA, compliance Officer of the California Restitutionary Fund,
Intervenor-Appellant.

Nos. 76-3495, 77-2045.

United States Court of Appeals,
Fifth Circuit.

Feb. 6, 1980.

Appeals were taken from orders of the United States District Court for the Southern District of Florida, James Lawrence King, J., in class action arising from the sale by a California corporation of direct distributorship contracts for the sale and distribution to the consuming public of its line of personal and home care products. The Court of Appeals, Coleman, Chief Judge, held that: (1) genuine issue of material fact existed as to whether repurchase direct distributorships sold to plaintiffs by corporation were investment contracts within the meaning of federal securities laws; (2) compliance officer of restitutionary fund which was set up by California state court judgment to remedy violations of state law by corporation in pyramid sales scheme had right to intervene in action and his application to intervene was timely since existing parties suffered no prejudice from delay; (3) district court failed to assess reasonableness of attorney fees proposed under settlement of class action with corporation requiring reversal of approval of settlement; (4) settlement as to corporation and 27 individual defendants was subject to reversal for failure to assess interests two categories of plaintiffs and whether settlement was fair, adequate and reasonable as to each; and (5) entry of injunction against enforcement of judgment obtained in California state court to remedy violations of state law by corporation was improper.

Reversed and remanded.

See also D.C., 412 F.Supp. 754.

1. **Federal Civil Procedure — 2511**

In class action litigation arising from sale by

California corporation of direct distribution contracts for the sale and distribution to consuming public of its line of personal and home care products, genuine issue of material fact existed as to whether repurchase direct distributorships sold to plaintiffs by corporation were investment contracts within meaning of federal securities laws, precluding summary judgment. Securities Act of 1933, §1 et seq., 15 U.S.C.A. §77a et seq.; Securities Exchange Act of 1934, §1 et seq., 15 U.S.C.A. §78a et seq.

2. Federal Courts — 544

One who has sought intervention of right may appeal from an order denying his application; appellate court will reverse if it concludes that he was entitled to intervene of right. Fed.Rules Civ.Proc. Rule 24(a), 28 U.S.C.A.

3. Federal Courts — 817

District court's determination as to timeliness of application to intervene will not be overturned on appeal unless abuse of discretion is shown. Fed.Rules Civ.Proc. Rule 24(a), 28 U.S.C.A.

4. Federal Civil Procedure — 311

Generally, courts must look to substantive law creating right being sued upon to determine compliance with real party in interest requirement of rule governing intervention. Fed.Rules Civ.Proc. Rule 24(a), 28 U.S.C.A.

5. Trusts — 117

Under California law, when a declaration of trust is made in writing, all previous declarations by the same trustor are merged therein, but when documents are executed contemporaneously with trust agreement and are cross-referenced to each other, they must be regarded as one instrument.

6. Trusts — 257

Under California law, terms of trust agreement may empower someone other than named trustee to sue and be sued on behalf of beneficiaries of trust.

7. Federal Civil Procedure — 149

Compliance officer of restitutionary fund which was set up by California state court judgment to remedy violations of state law by corporation in pyramid sales scheme was a "trustee of an express trust" within meaning of that term in federal rule of civil procedure, and was real party in interest for purposes of class action litigation arising from the sale by corporation of direct distributorship contracts. Fed.Rules Civ.Proc. Rule 17(a), 28 U.S.C.A.

See publication Words and Phrases for other judicial constructions and definitions.

8. Federal Civil Procedure — 320, 345

Compliance officer of restitutionary fund which was set up by California state court judgment to remedy

violations of state law by corporation in pyramid sales scheme had right to intervene in class action litigation arising from sale by corporation of direct distributorship contracts, and his application to intervene was timely where parties were not prejudiced by delay. Fed.Rules Civ.Proc. Rule 24(a), 28 U.S.C.A.

9. Federal Civil Procedure — 1699

Purpose of rule requiring trial judge to review any proposed settlement of class action is to protect nonparty members of class from unjust or unfair settlements affecting their rights. Fed.Rules Civ.Proc. Rule 23(e), 28 U.S.C.A.

10. Federal Civil Procedure — 1699

To minimize conflict between attorney and class, district courts must address issue of attorney fees before approving settlement of class action. Fed.Rules Civ.Proc. Rule 23(e), 28 U.S.C.A.

11. Federal Civil Procedure — 1698, 1699

If proposed settlement of class action leaves attorney fees to be fixed by court, court must set and conduct hearing in full sense of word and address fee issue; if court has not done so, he must require that notice be given to class of proposed attorney fees as well as rest of settlement agreement and afford anyone who objects an opportunity to be heard. Fed.Rules Civ.Proc. Rule 23(e), 28 U.S.C.A.

12. Federal Civil Procedure — 1699

District court is not bound by agreement of parties as to amount of attorney fees in settlement of class action. Fed.Rules Civ.Proc. Rule 23(e), 28 U.S.C.A.

13. Federal Civil Procedure — 1699

In fixing amount of attorney fees in settlement of class action, court must take certain factors into account, including difficulty of case and uncertainty of recovery; he is not merely to ratify a prearranged compact. Fed.Rules Civ.Proc. Rule 23(e), 28 U.S.C.A.

14. Federal Courts — 932

Approval of settlement of class action was subject to reversal where district court abdicated its responsibility to assess reasonableness of attorney fees proposed under settlement. Fed.Rules Civ.Proc. Rule 23(e), 28 U.S.C.A.

15. Federal Courts — 932

Approval of settlement of class action was subject to reversal where district court failed to assess interests of two categories of plaintiffs and whether settlement was fair, adequate and reasonable as to each. Fed.Rules Civ.Proc. Rule 23(e), 28 U.S.C.A.

16. Courts — 508(3)

In class action litigation arising from sale by California corporation of direct distributorship

contracts for the sale and distribution to consuming public of its line of personal and home care products, issuance of injunction against enforcement of previous judgment of California state court to remedy violations of state law by corporation in pyramid sales scheme was improper. 28 U.S.C.A. §2283.

17. Federal Civil Procedure — 161

Rule of civil procedure governing class actions is not an express exception to Anti-Injunction Act. Fed.Rules Civ.Proc. Rule 23(d), 28 U.S.C.A.; 28 U.S.C.A. §2283.

18. Federal Civil Procedure — 161

Rule of civil procedure governing class actions is a rule of procedure and creates neither a right nor a remedy enforceable in federal court of equity. Fed.Rules Civ.Proc. Rule 23(d), 28 U.S.C.A.

19. Courts — 508(3)

Fact that California class members had previously won judgment against corporation and began to recover did not deprive non-California members of class of property without notice or equal protection so as to entitle non-California members of class to injunction to enjoin enforcement of California judgment in subsequent federal class action. U.S.C.A.Const. Amend. 5; 28 U.S.C.A. §2283.

20. Courts — 508(2)

Securities Exchange Act does not constitute an "expressly authorized" exception to Anti-Injunction Act for private lawsuits. Securities Exchange Act of 1934, §21, 15 U.S.C.A. §78u; 28 U.S.C.A. §2283.

21. Courts — 508(2)

Federal court may not enjoin state court proceedings in order to decide private lawsuit brought under Securities Exchange Act of 1934. Securities Exchange Act of 1934, §21, 15 U.S.C.A. §78u; 28 U.S.C.A. §2283.

J. Russell Pitto, San Jose, Cal. and Marc M. Watson, Miami, Fla., for Bestline, Inc., et al.

Carl H. Hoffman, Miami, Fla., James H. Joseph, Pittsburgh, Pa., for Piambino, et al.

David Ferber, Sol., for amicus curiae. Ralph C. Ferrara, Gen. Counsel, S. Lee Terry, Jr., William A. Dietch, Attys., SEC., Washington, D.C.

Evelyn Langlieb Greer, Miami, Fla., for intervenor-appellant.

Michael R. Botwin, Deputy Atty. Gen., Dept. of Justice, Los Angeles, Cal., amicus curiae, for people of the State of California.

William C. Wolford, Asst. Atty. Gen., State of Wisconsin, Madison, Wis., amicus curiae, for State of Wis.

Appeals from the United States District Court for the Southern District of Florida.

Before COLEMAN, Chief Judge, GOLDBERG, and RUBIN, Circuit Judges.

COLEMAN, Chief Judge.

This litigation arose from the sale by Bestline Products, Inc.,[1] a California corporation, of direct distributorship contracts (or agreements) for the sale and distribution to the consuming public of its line of personal and home care products. Bestline's direct distributorships were an integral part of its multi-level distributorship system, a species of pyramid sales schemes.[2]

The complexities of this case remind us of the ancient Gordian Knot. Involved here are eleven lawsuits transferred to the Southern District of Florida for coordinated or consolidated pretrial proceedings with a

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[1]Bestline Products, Inc., is a California corporation wholly owned by Bestline Corporation, another California corporation. In this opinion these corporations will be collectively referred to as "Bestline".

[2]For a detailed analysis of such schemes, see Note, *Pyramid Schemes: Dare to be Regulated*, 61 Geo.L.J. 1257 (1973).

suit previously filed in that district.[3] The two appeals taken to this Court from those proceedings, and now before us, have also been consolidated.[4]

Included is a class of nearly 40,000 plaintiffs. There are several corporate defendants, a law firm defendant, and over 60 individual defendants. Swept up in the

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[3]In 1974 the Judicial Panel on Multidistrict Litigation transferred six cases to the Southern District of Florida for consolidation with the case of *Piambino v. Bailey*, No. 73-1230-Civ. *In re Bestline Products Securities and Antitrust Litigation*, 375 F.Supp. 926 (Jud.Pan.Mult.Lit.1974). Later, it transferred four Texas cases to the Florida court, 405 F.Supp 313 (Jud.Pan.Mult.Lit.1975), as well as one North Carolina case. Most of these cases were class actions and alleged violations of the federal securities laws and various state laws.

[4]In No. 76-3495, on August 6, 1976, the defendants filed notice of appeal from three different orders of the District Court: (1) the Order Determining Motions for Summary Judgment, dated March 19, 1976; (2) the Preliminary Injunction, dated July 7, 1976; and (3) the Order Allowing Reimbursement of Costs and Disbursements of James H. Joseph, dated July 15, 1976. The appellants filed their opening brief in December 1976, and the State of California filed an amicus brief in January 1977. The parties then began settlement negotiations and moved this Court for a stay of the appeal proceedings, which motion was granted.

Although the settlement which was finally approved by the District Court included a requirement that the defendants dismiss their appeal in No. 76-3495, they refused to do so when David Sylva appealed from the denial of his motion to intervene and from the order approving the settlement. The latter appeal was docketed as No. 77-2045, and the two appeals were consolidated for oral argument. In January 1979 the plaintiffs filed their opening brief in No. 76-3495.

proceedings are scores of lawyers, the attorneys general of seven states, the Federal Trade Commission, and the Department of Justice. Various state and federal courts have decided related cases.

In this appeal, the parties have raised many issues, including: (1) the management of class actions and complex litigation; (2) the interpretation of 28 U.S.C. §2283 (the "Anti-Injunction Act"); and (3) the definition of a "security" for purposes of the federal securities laws.

We hold that summary judgment declaring the distributorships to be securities was improvidently entered. After a consideration of all issues we reverse and remand for further proceedings not inconsistent herewith.

I.

BESTLINE'S ORGANIZATION AND HISTORY[5]

Bestline Products, Inc. began its activities in August, 1966, when defendants William E. Bailey and Jerry G. Brassfield organized a multilevel direct sales organization to sell and distribute a line of biodegradable soap products. Bailey and Brassfield had

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[5]Most of the discussion under this heading is taken from the District Court's Opinion and Order Determining Motions from Summary Judgment. *See In re Bestline Products Securities*, 412 F.Supp. 732 (S.D.Fla.1976).

previously been associated as distributors for Holiday Magic, Inc., a multilevel direct sales company which sold cosmetic products. Those men had additional experience with pyramid sales schemes resulting from their work with several other (ultimately unsuccessful) companies.

From its inception, Bestline was a successful venture, at least until the rising flood of lawsuits and regulatory actions began to overwhelm it. Bestline recruited other individuals with experience in multi-level direct sales and grew until it became an operation in all fifty states and several foreign countries. By March, 1972, its initial meager line of cleaning agents and home care products had expanded to sixteen in number. Six of the products were manufactured by Bestline in its own facilities in San Jose, California and Elk Grove Village, Illinois; various other companies manufactured the remaining items.

In order to share the ownership of the company with other loyal and devoted participants in its direct sales program, in 1968 Bailey and Brassfield organized the Bestline Corporation and sold their interest in Bestline Products, Inc. to the new corporation for $10 million. They sold some stock in the new corporation to others, but they retained the majority ownership for themselves. Bailey was the chief executive officer and chairman of the board until August 1973, when Brassfield returned to the organization he had left in 1970. As the business expanded, the officers and top executives of Bestline received ever-expanding compensation packages, including six-figure salaries and such perquisites as use of the corporate aircraft and yacht.

The most important factor in Bestline's success, and an equally important factor in its legal problems, was its "National Marketing Plan", a plan that was implemented through three levels of independent distributors. At the lowest level were the "Local Distributors",[6] who paid $5 annual dues and sold Bestline's products directly to the consuming public. At the second, or middle, level were the "Direct Distributors". The status of "Direct Distributor" could be achieved by a Local Distributor who sold approximately $5,000 worth of products in a month. The status could also be obtained by a prepurchase plan. A person could become a Direct Distributor by paying $3,400 in cash; for this sum, the purchaser received classification as a Direct Distributor and soap products having a retail price of $5,000 together with sales aids. Such a purchaser was required to serve as a Local Distributor for seven days and, while a Local Distributor, to buy $100 (later $500) worth of Bestline products. Unlike Local Distributors, Direct Distributors were not required to sell products to the consuming public or even to Local Distributors whom they sponsored. They could engage in recruiting Local Distributors to sell the products, but they could also recruit other persons to become prepurchase Direct Distributors. If a Direct Distributor successfully

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[6]Although Local Distributors could recruit other Local Distributors to sell for them, the profits achieved by a Local Distributor turned solely upon sales to the consuming public. Bestline paid no commissions or bonuses to persons at the lowest level. Consequently, no party to these suits has alleged that this aspect of the scheme violated the federal securities laws. As certified by the District Court, the class did not include any Local Distributors.

recruited two new Direct Distributors, he became qualified to move up to the third, and highest, level, that of "General Distributor". This level in the Bestline hierarchy could be attained only by persons who first qualified as Direct Distributors and then satisfied certain other requirements.

The district court certified as the class plaintiffs only prepurchase Direct Distributors. Thus, the action does not involve Local Distributors, Local Distributors who earned the status of Direct Distributor by selling soap products or General Distributors.

Profits at the various levels were in part dependent on the volume of sales to lower levels and to the consuming public. A Local Distributor purchased the products from his sponsoring Direct Distributor at a discount that varied from 30% to 52% off of the retail price, depending upon his monthly sales. A Direct Distributor purchased the products for resale to his Local Distributors and to the public at a 52% discount. At the top of the pyramid, a General Distributor purchased the products for resale to his Director Distributors, his Local Distributors, and the public at a 60% discount.

A person at any of the three levels could profit by selling Bestline's products to the public (which all levels were authorized to do) or by recruiting other distributors (which all levels were also authorized to do). In fact substantial sales of Bestline products were made, about $1,000,000 per month at one point. (The record is not clear, however, what part of these sales were made to consumers and what part remained in the hands of various classes of distributors.)

As is the case with most such pyramid sales schemes, however, the lure of big profits came not from the opportunity to sell Bestline's products to the consuming public but from the opportunity to recruit others who would in turn recruit or sell. The district court discussed four different methods by which Bestline Direct and General Distributors could profit from the recruitment of new distributors: (1) the release fee; (2) the standard commission; (3) the override commission; and (4) the special incentive bonus (SIB).

The release fee practice, which Bestline abandoned in 1970, was the simplest method by which a person in the top level profited from the recruitment aspect of the National Marketing Plan. Under this program, a Direct Distributor who wished to move up was required to pay Bestline a $2750 fee, of which Bestline paid $2250 to the Direct Distributor's sponsoring General Distributor (generally, the one who had initially recruited the Direct Distributor). Ostensibly, this fee was paid to release oneself from his General Distributor's organization and compensate the latter for the loss of commission which would be experienced when the Direct Distributor left that organization. This fee therefore provided General Distributors with an incentive to encourage their Direct Distributors to move up the pyramid. Equally as obvious, however, is the fact that the release fee provided no incentive for Direct Distributors.[7]

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[7]Unless, of course, it was the expectation that one would eventually move up to the position of General Distributor and then be in a position to recruit other Direct Distributors, who might eventually pay the release fee in order to move themselves up in the hierarchy.

The second method by which individuals profited from the recruitment of others was the standard commission. This resulted from the 8% differential in discounts between General and Direct Distributors, and it was applied to all "product movement" between those two levels. This standard commission therefore provided an incentive for General Distributors to recruit more Direct Distributors, to whom they could sell Bestline products at 48% of retail after having purchased such products from the company at 40% of retail. The General Distributors could therefore achieve a rapid 20% return on their outlays.

The override commission was a 3% commission paid to the sponsor of a sponsoring distributor. The sponsor of a sponsoring distributor was entitled to this commission solely because he had initially recruited the initial distributor, even though he may have played no part in the subsequent recruitment. This commission therefore provided an incentive for distributors to recruit people who in turn would be good recruiters and not merely good retailers of Bestline's products.

The fourth method, the special incentive bonus, was introduced by Bestline shortly after it eliminated the release fee practice. SIB's were paid on an annual basis to qualifying General, but not Direct, Distributors and were a progressive percentage of product movement. Product movement consisted not only of products that were sold to ultimate consumers, but also of products that remained in the hands of a distributor who either was unable to unload them on another distributor or was unwilling or unable to sell them to the public. A General Distributor had to account for at least $36,000 in product movement to be eligible for any SIB.

His commission would be 3.3% at that level, but if he could push $200,000 in products, his commission rate jumped to 15%, or earnings of $30,000.

One device utilized by Bestline to advance and implement corporate policy was the monthly meeting of its "Corporate Team", which included key home office officials, assistant vice-presidents, and Regional Directors. These meetings were used to announce changes in policy and to motivate Bestline's personnel. A key feature of these meetings was the constant exhortation to hold "Opportunity Meetings" and to adhere closely to the script provided by the company for use at these meetings.

The district court found that dozens, if not hundreds of opportunity meetings were conducted almost daily throughout the United States.[8] These meetings involved the gathering of a group of Bestline distributors and prospective recruits in a hotel or motel meeting room, or any other suitable place. The prosepcts were systematically exhorted to take advantage of the Bestline "opportunity". To insure uniformity at each of the thousands of Opportunity Meetings, Bestline distributed scripts for speakers to use at such meetings, as well as records, film strips, and

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[8]Bestline's Opportunity Meetings differed little from the meetings which have been integral parts of other pyramid sales schemes. *Compare SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 476 (5th Cir. 1974); *SEC v. Glenn W. Turner Enterprises, Inc.* 348 F.Supp. 766, 770-71 (D.Ore. 1972), *aff'd*, 474 F.2d 476 (9th Cir. 1973), *cert. denied*, 414 U.S. 821, 94 S.Ct. 117, 38 L.Ed.2d 53 (1973); *see generally* Note, Pryamid Schemes: Dare to be Regulated, 61 Geo.L.J. 1257, 1259 (1973).

copies of the "Bestline Business Opportunity Booklet." Bestline corporate officials frequently conducted the meetings at least to insure adherence to company policy.

The Opportunity Meetings were the means by which Bestline distributors were urged to build an "organization" of distributors whom they sponsored. The time and place of each Opportunity Meeting was reported to the Bestline home office and assembled into a regularly published "Corporate Calendar" which listed all the meetings currently planned across the country. By means of this calendar, Bestline distributors could, as they were urged to do by Bestline, refer friends or acquaintances in distant locations to a convenience Opportunity Meeting in their city or locale. If the distant prospect signed up for a distributorship, the referring friend became his sponsor and therefore received a share of the commissions paid on the products purchased from Bestline by the distant prospect, even if the referring friend took no part in the actual recruitment of the distant prospect other than inviting him to the Opportunity Meeting.

The Bestline system for computing the amount of regular commissions, override commissions and SIB bonuses which it paid to its distributors was based on Bestline's concept of "product movement," which gave credit for both retail and "wholesale" sales. Because of the Credit for wholesale business, one effect of the "product movement" was to reward distributors for the recruitment of new prepurchase Direct Distributors. And since prepurchase Direct Distributors were required to make large initial purchases to qualify for their position, a General Distributor who sponsored a

prepurchase Direct Distributor would receive a substantial commission, and possibly an SIB bonus, on the new distributor's initial purchase, even if the new distributor made no attempt to sell the products which he had purchased to the consuming public. Nor did the new prepurchase Direct Distributor need to sell any of his inventory in order to make a profit. He could instead concentrate his efforts on the "wholesale" part of the business, and try to recruit new prepurchase Direct Distributors whose initial purchases could be applied toward fulfilling his own requirements for becoming a General Distributor. The incentive for becoming a General Distributor is revealed by the fact that, while a General Distributor generally earned a lesser net discount on product sales (as little as 8%) than did a Direct Distributor (as high as 20%), only a General Distributor was entitled to receive commissions and credit toward his SIB bonus for the initial purchases made by newly recruited prepurchase Direct Distributors whom he sponsored.

Thus, although the class certified as plaintiffs includes only prepurchase Direct Distributors, the route to highest profits was by becoming a General Distributor. Becoming a Direct Distributor and then recruiting another Direct Distributor was the only way to achieve the top of the pyramid, Direct Distributor status.[9]

II.

BESTLINE'S LEGAL BATTLES

Prosperity to the contrary notwithstanding, Bestline soon found itself defending lawsuits brought by the federal government, by the attorneys general of seven states, and by numerous private plaintiffs.

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[9]According to the district court's opinion, prior to 1970 a Direct Distributor could qualify as a General Distributor by (1) recruiting a new prepurchase Direct Distributor to replace him in his sponsoring General Distributor's organization; and (2) paying a $2,750 release fee to Bestline, $2,250 of which was then paid by Bestline to the ascending distributor's former sponsoring General Distributor, and $500 of which was retained by Bestline. Beginning in 1970, however, a Direct Distributor could become a General Distributor only by (1) recruiting a Direct Distributor to replace himself in his sponsoring Direct Distributor's organization; (2) paying a $600 (later $700) fee to Bestline for attendance at "General Distributor's School"; and (3) generating, either through retail or "wholesale" sales volume (the latter category including the initial "pre-purchase" sales to newly recruited pre-purchase Direct Distributors), $5000 of "product movement" in a single month.

In 1971 Bestline entered into a consent decree with the Federal Trade Commission wherein it agreed to cease and desist from alleged unfair trade practices in connection with the recruitment of new distributors.[10]

On May 12, 1971, the State of California filed a civil suit against Bestline and certain of its officials *alleging violations of state law.*[11] On July 25, 1973, after a lengthy trial, the Los Angeles County Superior Court entered a written judgment in the case, ordering injunctive relief, restitution to certain California Bestline distributors, and a total of $1,902,500 ($1,000,000 against Bestline) in civil penalties. In addition, the order provided for the appointment of a receiver to effectuate the restitutionary provisions. After the state court judge had announced his decision from the bench, but two days before the written opinion issued, Bestline filed a Chapter XI bankruptcy petition in the Northern District of California. That court issued a stay order which prevented the California Attorney General from enforcing the state court judgment.

While the Chapter XI proceedings inched forward, extensive negotiations took place. New management took over control of Bestline and the California Attorney

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[10]The pertinent provisions of that consent decree can be found in *United States v. Bestline Products Corp.*, 412 F.Supp. 754, 760-61 n.2 (N.D.Cal.1976).

[11]Specifically, California alleged violations of California Business and Professions Code §17500 (deceptive advertising) and Civil Code §3369 (unfair competition). Earlier, on January 14, 1971, Bestline had signed a consent decree with the State and had agreed to cease and desist from employing certain marketing and advertising practices.

General's office negotiated with the new management. These discussions bore fruit on December 21, 1973, when the parties and the Superior Court signed a modified judgment that expanded the restitution program so that certain non-California Bestline distributors could participate in it. Pursuant to this modified judgment, Bestline transferred $4,085,936.61 into an irrevocable restitutionary trust to be administered by the Bank of America. Bestline agreed to make periodic payments, beginning January 1, 1976, to the fund until full restitution had been achieved, and it withdrew its bankruptcy petition. The modified judgment also empowered the Attorney General to seek termination of the trust agreement if Bestline failed to make regular payments. In addition, the court postponed Bestline's payment of $1,000,000 in civil penalties until full restitution had been achieved.

Three categories of distributors were eligible to participate in the California restitution program. These were:

(1) Each individual who became a Direct Distributor or a Candidate Direct Distributor in California after January 14, 1971, to and including July 25, 1973, and who requests a refund;

(2) Any individual who is entitled to restitution pursuant to agreement reached between any other state or political subdivision thereof or any federal department or agency and Bestline Products, Inc., and/or Bestline Corporation.

(3) Any other individual who became a Candidate Direct Distributor or Direct Distributor in Bestline in any state other than those specified [above] who has satisfied any of the following conditions: (1) the company approves the claim; (2) the distributor has received an arbitration award pursuant to a national plan of arbitration, or (3) pursuant to judgment.

The avowed purpose of this program as modified was to keep the company afloat so that restitution could be maximized. If large judgments were obtained against Bestline, and if subsequent plaintiffs sought to enforce those judgments, the company would become bankrupt. Therefore, any plaintiff obtaining a judgment could elect to join the California restitution program, or he could attempt to enforce his judgment, depending upon his own perception of which course of action he thought would enhance his recovery.

Bestline appealed the Superior Court judgment but did not challenge its restitutionary features. The lower court was affirmed on all issues appealed, *People v. Bestline Products, Inc.*, 61 Cal.App.3d 879, 132 Cal.Rptr. 767 (1976).

The record does not indicate how many individual cases, if any, proceeded to judgment, but public bodies brought a number of suits which either proceeded to judgment or were settled. The New York City Bureau of Consumer Protection and the Attorneys General of Missouri, Ohio, Pennsylvania, New Jersey, Texas, and Wisconsin successfully brought suits against Bestline on behalf of former Bestline distributors in their respective jurisdictions. All of these seven classes elected to join the California restitution program rather than execute their judgments.

In the meantime, private lawsuits against Bestline and various officers of the company were filed in several federal courts across the country, and the scramble for the assets of Bestline began in earnest. For example, on July 20, 1973, counsel for the Piambino plaintiffs filed their class action lawsuit in the Southern District of Florida.

Lead counsel[12] for the consolidated actions made several attempts in California courts to disrupt the California restitution payments. The initial effort began on September 20, 1974, when one of the two lead counsel sent a letter to the Bank of America, the fund trustee, claiming that the class had a prior equity in the trust and warning the bank that it "will be held liable to them [the class] for their proportional interest in any funds disbursed after your receipt of this letter." Another letter, dated October 8, 1974, threatened "to commence legal proceedings against the Bank of America to enjoin any distribution of funds from the Bestline trust . . . [and which would seek] recovery of the proportional interest in any funds disbursed by the Bank to which the putative class is entitled." Since the Bank was scheduled to disburse payments to the participants in the restitution program in the near future, it was concerned about these threats and petitioned the California Superior Court for instructions. After a hearing attended by all interested parties, including lead counsel for the Florida class, the state court ordered

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[12]The District Judge appointed as lead counsel for the consolidated proceedings the two attorneys, Carl H. Hoffman and James H. Joseph, who had filed the class action lawsuit on behalf of the Piambino plaintiffs in the Southern District of Florida. These two attorneys have acted as lead counsel throughout the litigation.

the bank to make the disbursements. Bestline did not appeal that decision, even though it may have been entitled to do so under state law. *See County of Alameda v. Carleson,* 5 Cal.3d 730, 97 Cal.Rptr. 385, 488 P.2d 953 (1971).

The very next day, lead counsel filed a class action suit in the Northern District of California alleging that the distribution of money through the restitution fund constituted "common law fraud and deceit" and deprived their clients of due process and equal protection. Plaintiffs sought an injunction "restraining Bank of America, [the compliance officer], Bestline, Bestline Corporation, [the California Attorney General] and the Superior Court from issuing any further instructions to [the compliance officer] and/or Bank of America inconsistent with the claims of [the plaintiff class], and restraining Bank of America from any distribution of said funds inconsistent with the rights of [the plaintiff class] to share ratably therein." Counsel then petitioned the Judicial Panel on Multi-district Litigation to treat the action as a tag-along case with the Florida cases. A conditional transfer order was summarily issued, but the defendants promptly moved to vacate that order. After a hearing, the defendants' motion was granted on February 14, 1975, whereupon the parties returned to the Northern District of California, where the court notified all the parties that a hearing would be held on March 28, 1975. Plaintiffs' counsel failed to appear at that hearing, and the court granted the defendants' motion to dismiss under Rule 12(b) *with prejudice.* Judgment was entered, the plaintiffs appealed, and the Ninth Circuit *dismissed* the appeal without opinion.

At this point, if not before, the California state court judgments became absolutely final and entitled to full faith and credit.

On April 2, 1976, pursuant to a complaint filed by the Federal Trade Commission, the United States District Court for the Northern District of California found that Bestline had violated the injunction issued as a part of the 1971 consent decree. Among other things, the Federal Trade Commission obtained a judgment of $1,036,000 against the defendant, William Bailey, dated July 19, 1976, *United States v. Bestline Products Corporation,* 412 F.Supp. 754 (N.D.Cal.1976). This money was paid into the registry of that Court.

In the meantime, as will hereinafter be related, the District Court in Florida had brought the enforcement of the California state court judgment to a halt by enjoining Bestline from complying with the California state court judgment. The District Court in California transferred the $1,036,000 from its registry to that of the Southern District of Florida for distribution to members of the plaintiff class in that Court.

After the total lack of success in both the State and Federal Courts in California, ending with the dismissal of the appeal in the Ninth Circuit, plaintiffs' counsel resorted again to the Southern District of Florida; where discovery proceeded apace.

On March 19, 1976, the District Judge rendered an opinion and order granting the plaintiffs' motion for summary judgment on the limited issue of whether the prepurchase Direct Distributorship agreements were

"securities" for purposes of the Securities Act of 1933 and the Securities Exchange Act of 1934. Meanwhile, on January 1, 1976, Bestline had made its first scheduled payment of $250,000 to the restitution fund, and it had notified the compliance officer that it would be able to make its second periodic payment, in the amount of $500,000, as scheduled on June 30, 1976. This apparently alarmed lead counsel and on June 18, 1976, less than two weeks prior to the scheduled date of payment, they moved the Florida District Court for a temporary restraining order to prohibit Bestline from transferring the money to the Bank of America. Lead counsel recognized the problem presented by 28 U.S.C. §2283, the Anti-Injunction Act, and submitted a brief to the District Court arguing that the court could issue the injunction on the ground that the plaintiff class had been deprived of some right secured to it by the 1871 Civil Rights Act, 42 U.S.C. §1981 *et seq.*, and on the ground that such an injunction was permitted under the "where necessary in aid of its jurisdiction" exception contained in the statute. The court held a hearing on June 30, 1976, the very day that Bestline was scheduled to make the payment, and after the Bank of America had gone to considerable expense in preparing checks and envelopes for the mailing of individual checks to the approximately 7,043 persons then participating in the restitution program.[13] A representative of the California Attorney General appeared at the hearing and argued,

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[13]Of this total, approximately 2300 resided at one time or another in California. Except for four people whom Bestline had authorized to participate in the fund, all of the other participating members joined the fund pursuant to judgments or settlements secured by six different state attorneys general or, in the case of New York City, by a Consumer Protection Bureau.

as did the defendants, that 28 U.S.C. §2283 barred the injunction. From the bench, the District Judge enjoined Bestline from making the payment, and, when the defendants demanded that the plaintiffs post a security deposit for damages in accordance with the requirements of Rule 65(c) of the Federal Rules of Civil Procedure, the Judge decided that the $500,000 would be deposited into the registry of the court and would serve as the security deposit. Unfortunately, we think, the written order completely avoided the question of whether the Anti-Injunction Act barred the injunction. The District Court simply opined that "it would be inequitable to allow the California Plan participants to continue to receive payments from Bestline where the other members of the Plaintiff class were effectively precluded from participating in the California Plan because of matters outside of their control." Thus, after being clearly apprised of the barrier posed by the Anti-Injunction Act, both in written briefs and in oral argument at the June 30 hearing, the District Judge failed to address the problem and issued the injunction.[14] The defendants filed a timely notice of appeal.

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[14]After the District Court enjoined Bestline, it missed six payments to the restitution fund:

Date	Amount
June 30, 1976	the greater of $500,000 or 50% of pre-tax profits
Jan. 1, 1977	$500,000
June 30, 1977	the greater of $750,000 or 50% of pre-tax profits
Jan. 1, 1978	$750,000
June 30, 1978	the greater of $1,000,000 or 50% of pre-tax profits
Jan. 1, 1979	$1,000,000

Bestline's new Chief Executive, Bailey, then began serious settlement negotiations with lead counsel. On October 20, 1976, the District Court entered an order preliminarily approving a settlement between Bailey and the class. The settlement provided that the funds obtained by the FTC and then on deposit in the registry of the court in the Northern District of California would be paid into the registry of the Southern District of Florida in return for a complete release of all claims against Bailey. It further provided that Bailey would not have to pay any money above what he had already paid in the FTC case, and that the funds could be used for the payment of attorneys' fees to Lead Counsel. The District Court, at Bestline's expense, sent notice to all members of the class concerning the proposed settlement and then held hearings, at which the Department of Justice appeared to protest the award of $250,000 in attorneys' fees to Lead Counsel out of funds generated by a successful FTC prosecution. Despite these objections, the Florida District Court concluded that Lead Counsel had made a substantial contribution to making those funds available for the plaintiff class,[15] and awarded the attorneys' fees in an order dated February 25, 1977.

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[15]In the Northern District of California, Judge Renfrew's extensive opinion does not mention any contribution by Lead Counsel to the FTC case. *See United States v. Bestline Products Corp.*, 412 F.Supp. 754. *In the Southern District of Florida no written findings of fact were issued in support of the conclusion that lead counsel had made a substantial contribution in the FTC case.*

III.

THE ALLEGED SECURITY

In the appeals now before us, the district court held (1) that there was no genuine issue as to any material fact bearing on the question of whether the prepurchase Direct Distributorships sold to the plaintiffs by Bestline were investment contracts within the meaning of federal securities laws and (2) that *those distributorships were securities.*

In *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473 (5 Cir., 1974), this Court held that for purposes of the Securities Act of 1933[16] and the Securities Exchange Act

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[16]Section 2(1) of the Securities Act of 1933, 15 U.S.C. §77b(1), provides as follows:

(1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

of 1934[17] a pyramid distribution system is a security. It was recognized that the test for an "investment contract" had been spelled out by the Supreme Court in *SEC v. W. J. Howey Company*, 328 U.S. 293, 298-299, 66 S.Ct. 1100, 1103, 90 L.Ed. 1244, 1249 (1946):

> "[A]n investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits *solely from the efforts of the promoter or a third party*. (Emphasis supplied).

After analyzing subsequent Supreme Court cases involving the investment contract issue along with lower court interpretations of *Howey*, and scholarly commentary, the *Koscot* Court concluded that a literal application of the *Howey* test, "solely from the efforts of the promoter or a third party", would frustrate the remedial purposes of the Acts. Therefore, the Ninth Circuit standard was adopted: "[W]hether the efforts

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[17]The definition of a "security" in §3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. §78c(a)(10), is substantially identical to that contained in the Securities Act, and the coverage of the Acts may be regarded as the same. *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 99 S.Ct. 790, 795 n. 7, 58 L.Ed.2d 808.

The question of whether the direct distributorships were "investment contracts" concerned the District Court. *See In re Bestline Products Securities*, 412 F.Supp. 732 (S.D.Fla.1976). In this Court, there is no contention that the phrases "certificate of interest or participation in any profit-sharing agreement" or "any interest or instrument commonly known as a 'security' " are broader in scope, for purposes of this case, than the term "investment contract".

made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise", 497 F.2d at 483 [quoting *SEC v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476, 482 (9 Cir., 1973), *cert. denied*, 414 U.S. 821, 94 S.Ct. 117, 38 L.Ed.2d 53 (1937)]. As applied to the facts in *Koscot*, it was held that efforts of the promoters in setting up and conducting the Adventure Meetings, which were designed to entice people to join the scheme, were the "essential managerial efforts" without which the enterprise would fail.

Since the *Koscot* decision the Supreme Court has decided two cases involving the definition of investment contracts, *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 99 S.Ct. 790, 58 L.Ed.2d 808 (1979), and *United Housing Foundation, Inc. v.*

Forman, 421 U.S. 837, 95 S.Ct. 2051, 44 L.Ed.2d 621 (1975).[18]

In both decisions, rejecting the arguments of the Securities and Exchange Commission, the Supreme Court reversed lower court holdings that the transactions at issue were investment contracts, and hence securities. The significant thing is that the Court expressly reaffirmed the test first enunciated in *Howey*, which had been on the books for thirty years.

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[18]See, also *SEC v. Sloan*, 436 U.S. 103, 98 S.Ct. 1702, 56 L.Ed.2d 148 (1978); *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 97 S.Ct. 1292, 51 L.Ed.2d 480 (1977); *Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1, 97 S.Ct. 926, 51 L.Ed.2d 124 (1977); *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976); *Ernst and Ernst v. Hochfelder*, 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976); *Foremost-McKesson, Inc. v. Provident Securities Co.*, 423 U.S. 232, 96 S.Ct. 508, 46 L.Ed.2d 464 (1976); *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 95 S.Ct. 2069, 45 L.Ed.2d 12 (1975); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975); *Securities Investor Protection Corp. v. Barbour*, 421 U.S. 412, 95 S.Ct. 1733, 44 L.Ed.2d 263 (1975); *see generally* Lowenfels, *Recent Supreme Court Decisions Under the Federal Securities Laws: The Pendulum Swings*, 65 Geo.L.J. 891 (1977).

The District Court in this case had the benefit of the *Forman* decision before granting summary judgment on the security issue, but it seems not to have grasped the significance of that case. According to the District Court, the language quoted in the text meant that the Supreme Court had restated the *Howey* test. "By focusing on the *quality* of the efforts of others, the Supreme Court read the word 'solely' out of the *Howey* test, it having become so much surplusage, thereby according to its prior *Howey* decision the flexibility originally intended." 412 F.Supp. at 737-38. The District Court failed to deal with the remainder of the *Forman* decision, however.

In *Forman* the Court stated, "[t]he touchstone is the presence of an investment in a common venture premised *on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others*"[19] (emphasis added), 421 U.S. at 852, 95 S.Ct. at 2060.

It should be noted that the test is to be applied in light of "the substance — the economic realities of the transaction — rather than the names that may have been employed by the parties", *Daniel, supra,* 439 U.S. at 558, 99 S.Ct. at 796.

In *Forman,* the Court emphasized, that, "in searching for the meaning and scope of the word 'security' in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality", 421 U.S. at 848, 95 S.Ct. at 2058.

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[19]The essential vice of chain or pyramid distribution schemes has been well documented. For example, if the founder recruited five distributors in the first month and if those five each recruited five more distributors in month two, and if each of these subsequent recruits enticed five people to join in the month following his own recruitment, over 244 million new distributors would be recruited in the twelfth month. Obviously, this would be impossible in a nation of only 220 million people. Equally as obvious is the fact that those who have the greatest risk of loss are those who enter the pyramid when the market is closest to saturation. This seems largely an element of chance, and it is just such a realization that has prompted courts all over the country to declare such schemes to be prohibited lotteries. *See generally* Annot., 54 A.L.R.3d 217, 227-31. The disclosure which would be necessary to inform a new investor of his prospects for success or failure would have to change almost daily in order to reflect the acquisition of new distributors. Needless to say, there would be substantial administrative obstacles connected with any such regime of disclosure.

As in *Koscot* and *Turner*, as well as in *SEC v. Galaxy Foods, Inc.*, 556 F.2d 559 (2 Cir., 1977), and *Bell v. Health-Mor*, 549 F.2d 342 (5 Cir., 1977), there were two distinct aspects to the distribution system set up by Bestline. These were the *retail sales* portion of the business on one hand and the recruiting portion on the other, but it would appear, without our so deciding, that these aspects were both integral parts of one common scheme. The degree of investor participation and control differed significantly with respect to each of these aspects.

Following the approach applied in *Securities and Exchange Commission v. United Benefit Life Insurance Company*, 387 U.S. 202, 207, 87 S.Ct. 1557, 18 L.Ed.2d 673 (1967), the district court here, like the courts in *Turner, Koscot, Galaxy*, and *Health-Mor*, separated these distinct aspects of the Bestline operation for purposes of its analysis. It also discussed the *Howey* formation of "profits" as meaning either "capital appreciation resulting from the development of the initial investment" or "a participation in earnings resulting from the use of investors' funds", 421 U.S. at 852, 95 S.Ct. at 2060.[20]

It is apparent that the purchasers of Bestline Direct Distributorships would not profit by "capital appreciation resulting from the development of the

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[20]In a footnote, the Court also noted the Ninth Circuit decision in *SEC v. Glenn W. Turner Enterprises, Inc., supra*. The Court stated that the "solely from the efforts of others" part of the *Howey* test was not presented in *Forman* and that it expressed no opinion on the Ninth Circuit's holding. 421 U.S. at 852 n. 16, 95 S.Ct. at 2060 n. 16.

initial investment". Neither is there any indication that prepurchasers of Direct Distributorships expected a "participation in earnings resulting from the use of investors' funds".

This relegates us to the standards long ago articulated, and more recently reaffirmed, by the Supreme Court.

An examination of the Bestline Business Opportunity Booklet, coupled with the Applications, Qualification Forms, and Agreements required to be executed by Direct Distributors, clearly established that the efforts of Bestline and its "Corporate Team" certainly constituted the "common thread" on which all of the distributor's "beads" were strung, *see Securities and Exchange Commission v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 348, 64 S.Ct. 120, 88 L.Ed. 88 (1943).

The person directing the Opportunity Meeting asks his audience of prospective joiners, "How do you do it? You get plenty of help. * * * *We all work together on this"* (App. 32a-33a, emphasis supplied).

Actually, it was not the Direct Distributorship, as such, but the General Distributorship that purportedly would yield the anticipated great returns. It was at the latter level that Bestline emphasized the building and supervisory aspects of the business, with which Bestline promised "plenty of help". The assurances of "plenty of help" infers that the person receiving that help would also have to be exerting efforts of his own, else there would be no need for help. "We all work together on

this" could be construed as notice that it would be necessary for the "investors" to "work".

Becoming first a Direct Distributor was prerequisite to becoming a General Distributor but the "over-all facts" and Bestline's presentation might be construed as holding out a promise that a prepurchase Direct Distributor would never have to retail the product at all; he would simply have to locate other prospects and bring them to the meetings, thus jumping immediately to General Distributorship level without exerting substantial effort.

There were parts of the Bestline presentation which would support a finding by a judge or a jury that no reasonable "investor" could have believed that he was relying *on Bestline.* At the General Distributors meetings the presentation constantly emphasized the retail aspects of the business. "The retail part may seem very elementary to you but I want you to understand how important it is, particularly to a General Distributor. . . . Although you're at 60%, 60% of nothing is nothing, so it's vitally important that sales occur, and of course, it is your job to assure that they do". The presentation then discussed the non-retail aspects of the business — building an organization and supervising it. The General Distributor's responsibility was to "train and motivate these people to do a good job". How? Plenty of help. It is implicit in this reference that retail sales will take place. The night meeting emphasized retail sales and the saleability of the product.

The meeting leader then discussed the prepurchase plan. This discussion focused on recruitment since that was integral to advancing from Direct Distributor to

General Distributor. Moreover, the promise of greatest profits was linked to becoming a General Distributor. The meeting also discussed the risk involved and there was evidence that might lead the trier of fact to conclude that Bestline intended to dispel (and dispelled) the belief that it was promising profits with no expenditure of effort. The presentation listed three ways to generate product movement volume: (1) retail sales through one's own accounts. "It generally takes experience in commercial selling to be successful in that area. But if you have that experience or acquire it, that can be one way . . . " (2) Simpler for those without sales experience is to sell that amount through local distributors. (3) "Strictly a hypothetical illustration", would be by recruiting people as Direct Distributors and training them as General Distributors. "You must train your people and continue to work closely with them". Finally, the printed material accompanying the Bestline presentation did mention personal efforts by the Direct Distributor.

In a summary judgment context what it all comes down to is:

1. Different inferences could be drawn from the facts in the record as to whether the Bestline Direct Distributorship Plan could be separated into two parts;

2. If the fact finder (judge or jury) were to hold that the Direct Distributorship Plan could be separated into two parts, one of which would be the recruitment of Direct Distributors, different inferences could be drawn from the facts in the record as to whether anticipated profits were to come solely by Bestline's efforts with no substantial personal effort on the part of the "investor".

This, of course, would be determined on the expectations of a "reasonable investor" as prompted by Bestline's standardized presentation, rather than the subjective beliefs of any particular individuals, *see International Brotherhood of Teamsters, supra,* 99 S.Ct. at 797; *United States Housing Foundation, Inc. v. Forman,* 421 U.S. at 852, 95 S.Ct. 2051. The motivation of particular individuals might vary; the application of the statute must be objectively based.

What a "reasonable investor" would under all the circumstances expect is for determination by the trier of fact in much the same manner as the determination of what a reasonable person would or would not have done concerning acts claimed to have been negligent. Such issues can properly be resolved by summary judgment only if (1) there is no genuine dispute concerning any material fact and (2) no conflicting inferences could be drawn from those established facts.

[1] After considering all the facts most favorably to the party against whom summary judgment is sought summary judgment may be entered, of course, if no jury could reasonably reach any conclusion except that reasonable investors did (or did not) believe they were buying into an enterprise whose profits would be determined by Bestline managerial and entrepreneurial methods with no substantial effort by the investor. Up to now, however, this is not such a case.

On what we have before us, the entry of summary judgment must be reversed and the case remanded for further proceedings conducted consistently with the applicable jurisprudence.

It should not be necessary for us to say that we intimate no opinion whatever as to how this case should be resolved on remand.

IV.

SYLVA'S APPLICATION TO INTERVENE

[2] It is well settled that one who has sought intervention of right may appeal from an order denying his application and that an appellate court will reverse if it concludes that he was entitled to intervene of right. *Cascade Natural Gas Corp. v. El Paso Natural Gas Co.*, 386 U.S. 129, 87 S.Ct. 932, 17 L.Ed.2d 814 (1967); *Stallworth v. Monsanto Co.*, 558 F.2d 257, 263 (5th Cir. 1977). In its order entering final judgment as to certain of the defendants, dated March 22, 1977, the District Court denied Sylva's petition to intervene as "both untimely and without merit". Thus, the Court concluded that Sylva did not satisfy Rule 24(a)'s requirements that an application for intervention of right be timely and that, on the merits, "[1] the applicant claims an interest relating to the property or transaction which is the subject of the action and [2] he is so situated that the disposition of the action may as a practical matter impair or impede his ability to protect that interest, unless [3] the applicant's interest is adequately represented by existing parties." Fed.R.Civ.P. 24(a).

[3] In the recent case of *Stallworth v. Monsanto Co., supra,* we exhaustively surveyed the jurisprudence on Rule 24's "timeliness" requirement and recognized

that this question is largely committed to the discretion of the district court. Consequently, its determination will not be overturned on appeal unless an abuse of discretion is shown. *Id.* at 263. Although such discretionary determinations must necessarily consider all the facts and circumstances of the particular case, *NAACP v. New York,* 413 U.S. 345, 366, 93 S.Ct. 2591, 2603, 37 L.Ed.2d 648 (1973), the *Stallworth* panel identified four factors which must, as a minimum, be considered in passing upon the timeliness of a petition to intervene. These factors were listed as: (1) the length of time during which the would-be intervenor actually knew or reasonably should have known of his interest in the case before he petitioned for leave to intervene; (2) the extent of the prejudice that the existing parties to the litigation may suffer as a result of the would-be intervenor's failure to apply for intervention as soon as he actually knew or reasonably should have known of his interest in the case; (3) the extent of the prejudice that the would-be intervenor may suffer if his petition for leave to intervene is denied; and (4) the existence of unusual circumstances militating either for or against a determination that the application is timely. *Id.* at 264-66.

Proper consideration of these factors generally cannot be divorced from a consideration of the merits of a prospective intervenor's application, however. For instance, factor 1 clearly requires an initial identification of the prospective intervenor's interest in the case, and factor 3 requires a similar identification of that interest in order to assess the potential of prejudice to him. Furthermore, the question of timeliness is at least partially linked to the question of adequate

representation. *See United Airlines, Inc. v. McDonald,* 432 U.S. 385, 394, 97 S.Ct. 2464, 2470, 53 L.Ed.2d 423 (1977) ("as soon as it became clear to the [intervenor] that the interests of the unnamed class members would no longer be protected by the named class representatives, she promptly moved to intervene to protect those interests."); *Allegheny Corp. v. Kirby,* 344 F.2d 571, 574 (2d Cir. 1965) (timeliness also turns on "when the interests of the proposed intervenors were no longer properly represented") (construing pre — 1966 rule). Due to these problems, we should analyze the merits of Sylva's application to intervene before considering whether it was timely.

First, what interest does Sylva have "relating to the property or transaction which is the subject of the action"? Our cases have required that intervention of right be supported by a "direct, substantial, legally protectable interest in the proceedings." *See United States v. Perry County Bd. of Education,* 567 F.2d 277, 279 (5th Cir. 1978); *Diaz v. Southern Drilling Corp.,* 427 F.2d 1118, 1124 (5th Cir. 1970), *cert. denied sub nom. Trefina A. G. v. United States,* 400 U.S. 878, 91 S.Ct. 118, 27 L.Ed.2d 115 (1970). Furthermore, Sylva "has standing to prosecute a suit in the federal courts only if he is the 'real party in interest' as that term is defined under Fed.R.Civ.P. 17(a). The stricture applies to intervenors as well as plaintiffs." *United States v. 936.71 Acres of Land, More or Less, in Brevard County, State of Florida,* 418 F.2d 551, 556 (5th Cir. 1969).

Sylva admits that he has never been a Bestline distributor at any level, nor has he ever been an employee or stockholder of the corporation. Although he

sought to intervene on behalf of the 7,043 participants in the California restitution fund and to be appointed as a representative of a subclass consisting of those persons, we need not consider whether such an interest would satisfy Rule 24(a) because Sylva clearly has another interest in this litigation which he may assert, namely, his own duties as Compliance Officer in administering the restitution fund and as receiver of the Bestline properties in California.

[4] It is the general rule that courts must look to the substantive law creating the right being sued upon to determine compliance with the real party in interest requirement, and for at least two reasons we look to California law in order to measure Sylva's claims. First, Sylva seeks to intervene in his capacity as the Compliance Officer of a restitution fund which was set up by a state court judgment to remedy violations of state law. In order to participate in that fund, every direct distributor with a judgment was required to waive "any and all rights and remedies available to him against corporate defendants with the exception of those rights and remedies available under the plan of restitution". This is obviously an interest created by the substantive law of California. Second, although this case involves primarily claims assertedly arising under federal law, it also involves pendent state law claims which the settlement purports to extinguish. At least to protect the interests of the California fund participants in those claims, we should look to California law.

[5, 6] We are satisfied that, as Compliance Officer, Sylva is the trustee of an express trust who may sue in the California state courts under Cal.Civ.Proc. Code Section 369 (West 1973), and in the federal courts under

Fed.R.Civ.P. 17(a). Under California law, "[t]he nature, extent, and object of a trust are expressed in the declaration of trust", Cal.Civ.Code Section 2253 (West 1973), and the primary rule in the construction of trusts is that the court must, if possible, ascertain and effectuate the intention of the trustor. *Ephraim v. Metropolitan Trust Company of California,* 28 Cal.2d 824, 834, 172 P.2d 501 (1946). In this case, the Superior Court is the trustor, see Cal.Civ.Code Section 2252 (West 1973), and we must therefore discern the intention of that court in creating the trust. "[W]hen a declaration of trust is made in writing, all previous declarations by the same trustor are merged therein" *id.* at §2254, but when documents are executed contemporaneously with the trust agreement and are cross-referenced to each other, as were the Modified Judgment, Instructions to Compliance Officer, and Trust Agreement in this case, they must be regarded as one instrument. See *Security-First Nat. Bank of Los Angeles v. Ogilvie,* 47 Cal.App.2d 787, 792, 119 P.2d 25 (1941). Finally, the terms of a trust agreement may empower someone other than the named trustee to sue and be sued on behalf of the beneficiaries of the trust. *Cf. Powers v. Ashton,* 45 Cal.App.3d 783, 119 Cal.Rptr. 729 (1975).

The California restitution fund was formally established by three separate documents — the Modified Judgment, the Instructions to Compliance Officer, and the Trust Agreement, all of which were signed in December 1973. The Trust Agreement is somewhat brief and contains only 12 short paragraphs. It named the Bank of America as trustee of the "irrevocable, express trust", and spelled out the

trustee's duties. These were: (1) to maximize the interest earned by the corpus of the trust; (2) to distribute payments to the participants in the fund as directed by the Compliance Officer; (3) to account to Bestline, the California Attorney General and the Compliance Officer for all payments made from the fund; and (4) to pay the fees and expenses of the Compliance Officer after Bestline and the California Attorney General had approved them. The agreement also expressly mentioned the Instructions to Compliance Officer (a copy of which was attached to the Trust Agreement) and stated that the Bank of America "shall have no discretion or authority or responsibility under the provisions of [the Instructions]." Finally, the agreement stated that it was to be governed by the laws of California, and it did not affirmatively state that the Bank of America was to have the duty to enforce the rights of the beneficiaries whom it represented.

In contrast to the Trust Agreement, the Instructions to Compliance Officer is a detailed document and defines the Compliance Officer's duties quite explicitly and definitively. He was to send proof of claim forms to each former distributor who became eligible to participate in the fund and to calculate the amount of refund due each person returning such form. He was to make the restitutionary payments on a pro rata basis according to a schedule established in the Instructions. Most importantly, the Instuctions provided that "Said Compliance Officer shall have full and complete authority and power to supervise, control, carry out, oversee and enforce the restitutionary provisions set forth herein. Said Compliance Officer shall perform all necessary and proper acts to effectuate

said purpose." To insure his ability to carry out these responsibilities, the Instructions granted him "all necessary power and authority to employ persons and legal counsel to assist him" and provided for the payment of his reasonable fees and expenses from the trust fund.

[7] Thus, it seems apparent that the express trust created by the California Superior Court contemplated a division of authority and responsibility. The Bank of America was to control and invest the funds and to make the payments as directed by the Compliance Officer. These duties are among those normally assumed by a trustee and are mainly ministerial. The Compliance Officer, although not formally designated as the "trustee" assumed significantly more important responsibilities and was, in fact, the real fiduciary in the arrangement. The Court gave him broad oversight responsibilities, charged him with enforcing the restitutionary provisions, and gave him the means (financial resources and manpower) to carry out his responsibilities. We have not the faintest doubt that the California Superior Court contemplated that the Compliance Officer, and not the Bank of America, would assume that vital and essential duty — the enforcement of the terms of the express trust on behalf of the beneficiaries of the trust — through legal action if necessary. We therefore conclude that the Compliance Officer is a "trustee of an express trust" within the meaning of that term in Rule 17(a), and is a real party in interest for purposes of this litigation.

Any doubts which might have been entertained about the correctness of that conclusion have surely

been dispelled by subsequent events. The Compliance Officer has kept himself abreast of the litigation in Florida from its inception and has been involved in several proceedings in the California Superior Court. In fact, Lead Counsel for the plaintiffs in this case even though that the Compliance Officer was such a critical actor that they named him as a defendant in their class action suit filed in the Northern District of California and sought to have him enjoined from issuing any further insructions to the Bank of America inconsistent with the claims of the plaintiff class. See p. 1314, *supra*. When that fact is considered, it is, to say the least, disingenuous for the plaintiffs now to deny that Sylva has any interest in the instant proceedings and to claim that the District Court properly denied his intervention.

The preceding discussion leads inexorably to the conclusion that Sylva, in his position of Compliance Officer, was in fact a trustee and, as such, had a "direct, substantial, legally protectable interest" in these proceedings.[21] He has at all times acted in the best interests of the beneficiaries of the restitution fund, and

[21]Because we have concluded that Sylva's position as Compliance Officer was an interest sufficient to warrant intervention of right, we have no occasion to address the separate question of whether his appointment as receiver of Bestline's California properties by the Superior Court on February 14, 1977, was sufficient to warrant intervention of right. The record on appeal is insufficiently developed on this point and reveals only that the California Court had appointed him and issued instructions to take possession of the assets, liquidate them, and transfer the proceeds to the restitution fund for ultimate distribution to its participants. The briefs of the parties have informed us that Sylva has carried out those duties, and, if that is indeed the case, his interest in these proceedings by virtue of his appointment as receiver might well be moot. We of course, express no opinion on any of these points.

the Florida litigation directly affected his ability to fulfill those responsibilities. Indeed, as will be demonstrated shortly, the Florida litigation threatened to snuff out his ability to comply with the directives of the California Superior Court.

We also think it quite clear that Sylva, as Compliance Officer, was so situated that the disposition of the action would as a practical matter impair or impede his ability to protect his interest as the representative of the restitution fund. Not only did the District Court intend to liquidate Bestline's assets, but he intended to distribute the proceeds *only* to class members "who have not previously been admitted to participation in the California restitutionary fund." Furthermore, all members of the California fund would be bound by the Florida judgment, except for those who had opted out early in the proceedings.

The manner in which the California fund members were treated in this litigation is illustrated well by the series of notices which they received. On November 22, 1974, the District Court certified a class of plaintiffs consisting of

> all persons who purchased or invested in Direct Distributorship contracts or agreements, or their equivalents, offered by Bestline Products, Inc., who never qualified as General Distributors of Bestline Products, Inc., or their equivalents, and who have not re-ordered products from Bestline Products,

Inc., within the six (6) months next preceding the date of this order . . .[22]

On January 15, 1975, the court notified potential class members, including participants in the California fund, that a class had been desig... ted and that unless they requested exclusion, their interests would be represented by lead counsel. At that time, the California fund had just made its second payment, and many of the participants undoubtedly were confused by this notice of yet another lawsuit. A substantial percentage took no action and thereby became members of the class. When the District Court's injunction prevented the mailing of the mid-1976 payments, many of the California fund participants became anxious about the delay and contacted the Compliance Officer, who informed them that an appeal had been taken and that there was no cause for alarm. In December 1976, the District Court preliminarily approved the settlement with William Bailey and sent notice to all members of the class, along with a proof of claim form. This notice, however, clearly stated that *no* payments would be distributed to persons who had previously participated in the California fund. It also stated that the Court expected to take no further action with respect to the money obtained from Bestline until its appeal had been decided; as events later unfolded, this promise proved to

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[22]As finally modified on October 21, 1976, the class included

all persons who purchased or invested in Direct Distributorship contracts or agreements, or their equivalents, offered by Bestline Products, Inc., who never qualified as General Distributors of Bestline Products, Inc., or their equivalents, and who are not active distributors as evidenced by current renewal of their mailing list privileges.

be an empty one. Understandably, many of the California group did not return proof of claim forms to the court. In December 1977 the court preliminarily approved the Bestline settlement and then sent notice of the proposed settlement *only* to those persons who had returned the proof of claim forms. Thus, it appears that the California fund participants were lulled into mistakenly thinking that their rights were being protected and that they were members of the plaintiff class. Suddenly, the court informed them that they would not participate in the funds distributed pursuant to the settlement. When they did not return proof of claim forms because they knew that they would get no money, the court declined to send them notice of the final, more important settlement (to be discussed, post).

Thus, the members of the California group were not given the treatment contemplated by the law, and they would be bound by a final judgment which completely shut them off from any hope of monetary recovery. It necessarily follows that Sylva's ability to protect his interest as a trustee would not only be impeded or impaired, but it would be utterly destroyed.

Much of the foregoing discussion makes it clear that Sylva was not represented at all in this litigation when the parties agreed to a settlement, one provision of which was that Bestline would abandon its appeal to this Court. Sylva was then, and only then, left "without a friend in this litigation." *See Atlantis Development Corp. v. United States,* 379 F.2d 818, 825 (5th Cir. 1967).

[8] To sum up, we conclude that, on the merits, Sylva was entitled *of right* to intervene.

The only remaining inquiry is whether his application was timely.

Each of the *Stallworth* factors on timeliness points toward the conclusion that the application was timely. First, although the Compliance Officer knew as early as June 30, 1976, when the injunction issued, that he had an interest in the litigation that might be impaired, there was absolutely no reason for him to intervene at that time. Bestline immediately appealed and filed a sterling brief with this Court. In addition, Bestline's attorneys met on several occasions with the Compliance Officer, the California Attorney General, and the Superior Court Judge and assured these people that they were prosecuting the appeal diligently and in good faith.[23] In reliance upon those representations, and upon

[23]Sylva outlined the position of the Superior Court as follows in his deposition:

> Q. Concerning your discussions with Bestline about the appeal, you indicated that you had monthly hearings before Judge Hupp and there was discussions at that time. Can you give me a little bit more detail about the discussions, what was indicated about Bestline pursuing the appeal?
>
> A. [Compliance Officer] Only that — okay, to give you some background, upon the five thousand [sic] being paid over to the Florida Court, California Attorney General's Office took that as being a breach of the agreement between Bestline and the Attorney General's Office, and immediately sought to enforce its judgment, have a receiver appointed.

At the same time, as we understand it, there were motions in Florida for the appointment of receivers. Judge Hupp did not want this thing to deteriorate into a race to the courthouse to determine which group of people obtained the judgment, and got the most

the obviously adequate representation of Bestline's attorneys, the Superior Court Judge refused the Attorney General's request for a receivership and Sylva did not attempt to intervene. On January 28, 1977, when

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Footnote 23 (Continued)

money. He rather would have liked to have seen some sort of a cooperative effort in resolving the whole matter, making sure all of the people, including the Florida people, received at least partial restitution of the funds that they had been bilked out of.

In light of this appeal [of] Judge Hupp, he was advised that the court ordered — the judgment of the Florida Court was being appealed, and that the appeal was progressing nicely and that the briefs were being filed or had been filed, you know, each month and there would be a progress report by Mr. Pitto and Mr. Humphreys [attorneys for Bestline]. Those were thoughts in mind — but in the meantime the California Attorney General's Office is champing at the bit to close down Bestline. They are taking a very aggressive posture on behalf of, I guess, the citizens of California and all the other attorney generals who agreed with their posture.

It was in light of these discussions that the trial court, the California Superior Court, would not rule on the motions of the Attorney General to shut everything down. It just — preservation of the status quo, let's not get excited here, things are going to work out, was in light of those remarks of the judge and reports by Bestline's attorneys that the thing continued to rock along from July up until February.

* * * * * *

Q. So that the Attorney General put off the proceeding on his receivership motion, and the court put off ruling on those motions, and you put off taking any action in Florida on the basis that Bestline was appealing this specific seizure of the half a million dollars?

A. Yes, that's correct . . . (A. 758-760).

the settlement agreement was filed, Sylva then knew that his interests were no longer adequately represented by Bestline, and his motion to intervene was filed on February 14. This delay of a mere seventeen days cannot rationally be denominated as unreasonable.

Furthermore, the existing parties have suffered no prejudice from the delay. This is not a case where intervention was attemped after the entry of a final judgment, *see United Airlines, Inc. v. McDonald,* 432 U.S. 385, 97 S.Ct. 2464, 53 L.Ed.2d 423 (1977); *McDonald v. E. J. Lavino Co.,* 430 F.2d 1065, 1972 (5th Cir. 1970); nor is it a case where more hearings must be held in the lower court. In this case, Sylva presented three witnesses at the hearing on the settlement and fully developed his position. The parties are in exactly the same position they would be if some members of the class had objected to the settlement and then taken an appeal to this Court. As has already been demonstrated, there was a distinct probability that the confusing, if not deceptive, series of notices guaranteed that no members of the California group would appear at the hearing to protest the settlement.[24] In short, the parties have not

[24]Sylva's three witnesses testified that they had difficulty understanding the notice and that they did not need to file the proof of claim form since they had previously filed in California.

"Q. (Ms. Greer) Did you take any steps to file a Proof of Claim Form?
A. (Norman Feinberg) No.
Q. Why didn't you file a Proof of Claim form after trying to read that, the Notice?
A. Well, I thought I didn't have to.
Q. Why did you think you didn't have to?
A. Because I already had. There was a contract entered between New York City and Bestline. And then I

been prejudiced legally by the brief delay in filing the application to intervene.

It is unnecessary for us to recount the substantial prejudice which will be visited upon Sylva and the

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Footnote 24 (Continued)

> subsequently asked three lawyers, which [sic] said 'I don't know how an agreement entered by a court could be nullified, so that agreement would have to stand.' Now, I thought I would suffer if I would subscribe to this." (A. 808).
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> * * * * * *
>
> "Q. (Ms. Greer) So the fact that you had already filed a claim in California, you had been notified you didn't have to participate, that convinced you not to file in Miami?
> A. (Valentin Dominguez) I thought I didn't have to.
> Q. Did you speak to any other Bestline distributors concerning the Notice?
> A. Yes, I did; a couple distributors. And in fact one of them was from California, and he was in the same — I don't even know the name of the fellow. He happened to ask me that I was a distributor because he saw some of the products that I was using; and he was from California. And as I understand it, he didn't participate in the Class neither.
> Q. Do you have any personal knowledge of why he didn't participate?
> A. We discussed the situation. And he says, 'Well, we don't have to. We covered from California.' " (A. 816-817).
>
> * * * * * *
>
> "Q. (By Ms. Greer) Mr. Dominguez, is it correct that the reason you did not file here in Florida is because you had already filed a claim in California?

members of the California group if his motion to intervene is denied. In addition to the facts already recounted, it should be noted that the District Court also intended to appoint a receiver with instructions to liquidate all of Bestline's assets. Such an action might have affected Sylva's ability to carry out the Superior

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Footnote 24 (Continued)

A. Right. And they have all the records that I have, plus the fact that the form that I got from Florida requires me to file an inventory and an amount of money that I invested in Bestline. I don't have anything like that because it was sent to California.
Q. Then you sent all of your documents and supporting information to California when you filed your claim there?
A. To California, right." (A. 818).
"Q. (By Ms. Greer) Please tell the Court what you did when you received the Notice.
A. (By Susie Rosenrot) When I received the letter, you know, I answer saying I don't see any I have to make another claim because I already did it." (A. 822).

* * * * * *

"Q. (By Ms. Greer) Mrs. Rosenrot, what steps did you take to try to get information about the Notice? What did you do to try to get information?
A. I wrote the letter to Mr. Dan Sylva saying that I did not see why I have to do it all over again because I already filed it so I could not understand it.
Q. Did you read the Notice?
A. I read it but I could not understand too much, you know. I don't know why I had to do that." (A. 823).

* * * * * *

Court's instructions to him to liquidate Bestline's California assets. We also think that the manner in which this group was treated in the Florida litigation, including the fact that the District Court failed to employ the subclassing power spelled out in Rule 23(c)(4)(B) and to designate a representative for the California group, is an "unusual circumstance" militating for a determination that the application is timely. *See Stallworth, supra* at 266,

Therefore, we hold that it was error as a matter of law to deny Sylva's application to intervene and we reverse on this point.

V.

THE BAILEY AND BESTLINE SETTLEMENTS

By separate orders, the District Court approved two

Footnote 24 (Continued)

"Q. (By Ms. Greer) Did you file a Proof of Claim form here in Florida?
A. No.
Q. Other than writing that letter?
A. That's right.
Q. You wrote that letter for more information?
A. That's all.
Q. Do you have the documents for your claim or did you send them to California?
A I sent everything to California when I made the claim.
Q. So that the California Fund has all of your documents and the claim form?
A. That's right." (A. 825-826).

* * * * * *

settlements. In the first order, dated February 15, 1977 (the Bailey Settlement), the Court entered final judgment as to defendant William Bailey and dismissed all claims against Bailey with prejudice. *Bailey gave no consideration whatsoever for the release of these claims;* the Court's order merely directs him to apply to the Northern District of California pursuant to the final judgment in the FTC case for an order directing the clerk of that court to transfer the amount of $1,036,000 to the Southern District of Florida. No notice of appeal was filed from the February 15 order, nor could there have been due to the lack of a Rule 54(b) certificate. On February 25 the District Court directed the payment of $250,000 in attorneys' fees to lead counsel from the Bailey settlement funds.

In the second order, dated March 22, 1977 (the Bestline Settlement), the District Court approved a settlement to which Bestline and 27 individual defendants had subscribed. In return for the dismissal of all claims against them with prejudice, the defendants agreed: (1) to pay $900,000 (collectively); (2) to tender a note for $300,000 (executed by Bestline Products, Inc. and guaranteed by Brassfield); (3) to pay whatever sums might be realized by liquidating Bestline's assets (approximately $600,000); and (4) to waive any claim to the $491,636.59 deposited with the court pursuant to the preliminary injunction, plus interest. This settlement also provided that attorneys' fees of $750,000 and expenses of up to $50,000 would be paid out of this fund. The March 22 order both denied intervention and entered final judgment as to the settling defendants.

Our jurisdiction to review the merits of the settlement can be supported on three grounds. First,

this may be a case for invoking the "hardship finality" doctrine of *Forgay v. Conrad*, 47 U.S. (6 How.) 201, 12 L.Ed. 404 (1848), since the District Court immediately ordered the payment of attorneys' fees out of the settlement proceeds. This was surely an execution on the judgment. *See generally* 15 C. Wright, A. Miller & E. Cooper, Federal Practice & Procedure §3910 (1976). In the circumstances of this case, there seems to be no reason not to review the merits of the settlement since the intervenor has already presented his evidence and arguments to the lower court. Second, the order entered final judgment as to Bestline, which had been enjoined by the court since June 30, 1976. The order was therefore appealable under 28 U.S.C. §1292(a)(1) as an interlocutory order dissolving an injunction. Finally, the order appointed lead counsel as "trustees" of the real and personal property of Bestline with instructions to liquidate the property within six months in a commercially reasonable manner. We have no doubt that this was in effect an appointment of a receiver and was an order appealable under 28 U.S.C. §1292(a)(2). "A receiver by any other name, or by no name, is still a receiver." *United States v. Sylacauga Properties, Inc.*, 323 F.2d 487, 490 (5th Cir. 1963).

We shall examine only Sylva's objections to the Bestline settlement.

[9] Rule 23(e) requires the trial judge to review any proposed settlement of a class action. The purpose of this salutary requirement is to protect the nonparty members of the class from unjust or unfair settlements affecting their rights. 7A C. Wright & A. Miller, Federal Practice & Procedure §1797, at 226 (1972). Conflicts

may arise between the attorney and the class, between the named plaintiffs and the absentees, and between various subclasses.

[10, 11] To minimize the first conflict — that between the attorney and the class — district courts must address the issue of attorneys' fees under the standards of *Johnson v. Georgia Highway Express*, 488 F.2d 714 (5th Cir., 1974). If the agreement leaves attorneys' fees to be fixed by the Court then, as stated in *In re Air Crash Disaster at Florida Everglades*, 549 F.2d 1006, 1021 (5th Cir. 1971):

> The district court must set and conduct a hearing in the full sense of the word and must address the fee issue under the *Johnson* standards. [C]ounsel must offer relevant evidence and must be available for cross-examination. The court should enter findings of fact and conclusions of law setting out the basis for the fee award and adequately presenting the issue for further appellate review should this be necessary.

[12, 13] *See also Norwood v. Harrison*, 581 F.2d 518 (5th Cir., 1978); *Premier Corp. v. Serrano*, 578 F.2d 566 (5th Cir.), *cert. denied sub nom. Premier Corp. v. Shevin, Shapo & Shevin, P.A.*, 439 U.S. 1003, 99 S.Ct. 613, 58 L.Ed.2d 678 (1978). If he has not done so, then he must require that notice be given to the class of the proposed attorneys' fees as well as the rest of the settlement agreement and afford anyone who objects an opportunity to be heard. Finally he must himself determine whether the attorneys' fees proposed are

reasonable. A district court is not bound by the agreement of the parties as to the amount of attorneys' fees. *Foster v. Boise-Cascade, Inc.*, 577 F.2d 335 (5th Cir. 1978), affirming 420 F.Supp. 674 (S.D., Tex., 1976). In fixing the amount of attorneys' fees the court must, of course, take all of the *Johnson* criteria into account, including the difficulty of the case and the uncertainty of recovery. He is not, however, merely to ratify a pre-arranged compact.

The second and third conflicts are much more difficult to prevent and police. Generally, courts depend upon structuring the settlement process to promote adequate representation and, hopefully, fair settlements. As a backstop, the law requires that the trial court evaluate whether the settlement is fair, adequate and reasonable and is not the product of fraud or collusion. *Pettway v. American Cast Iron Pipe Company,* 576 F.2d 1157, 1169 (5th Cir. 1978); *Cotton v. Hinton,* 559 F.2d 1326, 1330 (5th Cir. 1977); *Miller v. Republic National Life Insurance Company,* 559 F.2d 426, 428, 429 (5th Cir. 1977); *Young v. Katz,* 447 F.2d 431, 433 (5th Cir. 1971). Against these concerns must be weighed the general policy of the law to favor settlements and to uphold them whenever possible because they produce an amicable resolution of disputes and minimize demands on judicial time and resources. *Pettway, supra,* at 1214; *Miller, supra,* at 428.

We are convinced that the District Court fell into serious error when it approved the attorneys' fees proposed in the Bestline settlement. The order entering final judgment states:

> This court is not being asked to set reasonable attorney's fees in conjunction with the instant settlement; rather the court is being presented with a proposed settlement, agreed to by all parties and unopposed by the class, which incorporates an award of attorney's fees in the amount of $750,000 as a vital part of the settlement. Certainly, different procedures and considerations might obtain were the court being requested to initially fix an attorney's fee. Since the award and amount of attorney's fees comes before the court in the posture of an unopposed settlement, the court finds that the amount is reasonable under the circumstances of this protracted and complicated case. (Emphasis in original.)

[14] On this reasoning, the District Court abdicated its responsibility to assess the reasonableness of attorneys' fees proposed under a settlement of a class action, and its approval of the settlement must be reversed on this ground alone.

On this appeal, the parties to the settlement urge that the record is adequately developed to enable this Court to independently evaluate the reasonableness of those fees. This is not our normal practice, however, since the District Court is infinitely better situated to conduct the factual inquiry necessary under *Johnson*, and since we are not asked to determine reasonable attorneys' fees incident to an appeal to this Court. *See Davis v. Roadway Express, Inc.*, 590 F.2d 140 (5th Cir. 1979)

[15] Regrettably, this does not end the matter. For reasons about to be stated, we must vacate in its entirety the order entering final judgment as to Bestline and 27 individual defendants.

This is demanded by the failure to assess the interests of the two categories of plaintiffs and whether the settlement was fair, adequate and reasonable *as to each.*[25] One group of plaintiffs was comprised of the 7,043 participants in the California restitution fund, all of whom had either reduced their claims against the defendants to a judgment or had settled. Approximately $4.5 million had been distributed to these persons before the District Judge issued his preliminary injunction halting further payments from Bestline to the Bank of America. Although that recovery may seem large when compared to the proposed settlement in this case, it must be remembered that those 7,043 people had an average claim against Bestline of $3000 each, for a total claim of perhaps $21 million. Rather than execute their judgments and force Bestline into bankruptcy, those 7,043 people chose to accept smaller installment payments and to keep Bestline afloat for the greater good of all concerned. Cf. *Marshall v. Holiday Magic, Inc.*, 550 F.2d 1173, 1178 (9th Cir. 1977) (approving a

[25]If this were simply a case of defining the zone of acceptable settlements, we would look to the standards set forth by the Supreme Court in a bankruptcy approval case, *Protective Committee v. Anderson*, 390 U.S. 414, 424-25, 88 S.Ct. 1157, 20 L.Ed.2d 1 (1968). Those criteria would be especially applicable in this case because the assets of the corporation were so likely to be liquidated. *See also Cotton v. Hinton*, 5 Cir. 1977, 559 F.2d 1326; *Miller v. Republic National Life Ins. Co.*, 5 Cir. 1977, 559 F.2d 426, 429; *Developments in the Law — Class Actions*, 89 Harv.L.Rev. 1318, 1573-75 (1976).

similar settlement in a pyramid scheme nearly identical to that involved in this case). Since the issuance of the preliminary injunction, Bestline has failed to make at least $4,500,000 in payments to the California restitution fund. *See* note 14, *supra.* Therefore the members of the fund have been deprived of over $600, on the average, to which they were entitled as a result of their judgments against Bestline. The interest of these 7,043 people in protecting their judgments has not been adequately recognized or protected. This is not a bankruptcy proceeding in which the debtor's assets are being parcelled out to creditors on an equitable basis.[26] The participants in the California fund all had judgments that were entitled to full faith and credit under Article IV of the Constitution and 28 U.S.C. §1738. As the amicus brief filed by the State of Wisconsin indicates, those 7,043 people waived their rights to pursue any claims against Bestline, either as part of their judgments or upon joining the California fund. Unless those waivers were somehow not entitled to full faith and credit, it would seem that those 7,043 people never should have been included in the class. The record on appeal does not permit us to rule definitively

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[26]The February 10, 1977, Notice of Proposed Partial Settlement of Litigation contains some interesting statistics concerning the composition of the class which was certified. Notice was originally mailed to approximately 34,000 potential plaintiffs. 3,744 of these elected to exclude themselves from the litigation, and 8,779 of the notices were returned as undeliverable. Of the remaining class members, 4,332 completed and returned a proof of claim form. Apparently, the District Judge intended to distribute the settlement proceeds only to those 4,332 people. The record on appeal does not indicate how many of the California group excluded themselves from the litigation or how many filed proof of claim forms in Florida.

on this point, however, and we shall assume that the California fund participants constituted a subclass in this litigation. Unless it was proper for the District Judge to enjoin Bestline from complying with those judgments, a question which is answered in the negative in part VI of this opinion, the District Court erred by not making the California group whole out of the settlement proceeds, or at least according them an absolute priority to all such funds. Furthermore, since those 7,043 people were already entitled to such funds (up to $4,500,000 plus interest), this litigation has generated no common fund from which to pay attorneys' fees and expenses.

Thus, the result which we reach, by assuming that the 7,043 California fund participants were properly included in the class as defined by the District Court, is the same as that which would have been reached if those persons had not been included in the class and if the preliminary injunction had not issued. By concluding that those persons are entitled to settlement proceeds up to $4,500,000 plus interest, they are placed in the same position they would have been in if Bestline had made all the scheduled payments to the trustee. If, however, Bestline would have defaulted on those payments before now, the California class would still have obtained Bestline's assets through liquidation long before this settlement.

Therefore, the order approving the Bestline settlement and entering final judgment as to the subscribing defendants is vacated in its entirety.

VI.

THE PRELIMINARY INJUNCTION

[16] In the face of Rule 52(a)'s requirement that courts set forth findings of fact and conclusions of law which form the grounds for granting interlocutory injunctions, and after having been clearly apprised of the barrier presented by 28 U.S.C. §2283 (the "Anti-Injunction Act"), both by briefs and oral argument, the District Judge brushed past the statute in the belief that it would be "inequitable" not to issue the injunction. Since the appeal in No. 76-3495 has not been dismissed, and since Bestline has represented to this Court that it would not move to dismiss if Sylva were allowed to intervene in No. 77-2045, we clearly have jurisdiction under 28 U.S.C. §1292(a)(1) to review the issuance of that injunction. We reverse.

The Anti-Injunction Act, the predecessor of which was enacted in 1793, has long been an important and integral part of our federal system. As amended in 1948, it now provides:

> A court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments.

28 U.S.C. §2283. The Supreme Court has on many occasions explicitly declared that this statute must be given a strict construction due to the sensitive nature of federal interference with state court proceedings.

> On its face the present Act is an absolute prohibition against enjoining state court proceedings, unless the injunction falls within one of three specifically defined exceptions. The respondents here have intimated that the Act only establishes a "principle of comity," not a binding rule on the power of the federal courts. The argument implies that in certain circumstances a federal court may enjoin state court proceedings even if that action cannot be justified by any of the three exceptions. We cannot accept any such contention. . . . [We] hold that any injunction against state court proceedings otherwise proper under general equitable principles must be based on one of the specific statutory exceptions to §2283 if it is to be upheld. . . .

Mitchum v. Foster, 407 U.S. 225, 229, 92 S.Ct. 2151, 2155, 32 L.Ed.2d 705 (1972), *quoting Atlantaic Coast Line R. Co. v. Brotherhood of Locomotive Engineers,* 398 U.S. 281, 286-87, 90 S.Ct. 1739, 26 L.Ed.2d 234 (1970). *See also Amalgamated Clothing Workers v. Richman Bros.,* 348 U.S. 511, 75 S.Ct. 452, 99 L.Ed. 600 (1955); *Carter v. Ogden Corp.,* 524 F.2d 74, 76 (5th Cir. 1975); *International Ass'n of Machinists & Aerospace Workers v. Nix,* 512 F.2d 125, 129 (5th Cir. 1975).

Furthermore, it has long been "settled that the prohibition of §2283 cannot be evaded by addressing the order to the parties or prohibiting utilization of the results of a completed state proceeding." *Atlantic Coast Line R. Co., supra,* 398 U.S. at 287, 90 S.Ct. at 1743, *citing Oklahoma Packing Co. v. Gas Co.,* 309 U.S. 4, 9,

60 S.Ct. 215, 84 L.Ed. 537 (1940), and *Hill v. Martin*, 296 U.S. 393, 403, 56 S.Ct. 278, 80 L.Ed. 293 (1935). In *Hill*, Justice Brandeis wrote as follows for a unanimous court:

> The prohibition of [§2283] is against a stay of "proceedings in any court of a State." That term is comprehensive. It includes all steps taken or which may be taken in the state court or by its officers from the institution to the close of the final process. It applies to appellate as well as to original proceedings; and is independent of the doctrine of *res judicata*. It applies alike to action by the court and by its ministerial officers; applies not only to an execution issued on a judgment, but to any proceeding supplemental or ancillary taken with a view to making the suit or judgment effective. The prohibition is applicable whether such supplementary or ancillary proceeding is taken in the court which rendered the judgment or in some other. And it governs a privy to the state court proceeding . . . as well as the parties of record. Thus, the prohibition applies whatever the nature of the proceedings

296 U.S. at 403, 56 S.Ct. at 282-283 (footnotes omitted). Although the plaintiffs make a feeble attempt to argue that the injunction did not stay "proceedings in a State court", *Hill* leaves absolutely no doubt that the scheduled payment of $500,000 to the trustee of an express trust set up by a judgment of the California Superior Court was, at the least, a "proceeding supplemental or ancillary taken with a view to making

the suit jor judgment effective." Therefore, we cannot accept this argument and proceed to determine whether the injunction can be justified by any of the three express exceptions.[27]

A. *The "expressly authorized" exception*

[17, 18] The plaintiffs first argue that the injunction was "expressly authorized" by Fed.R.Civ.P. 23(d), and claim that the rule cannot insure the fair and efficient conduct of class actions unless injunctions are permitted against state court proceedings by absent class members. The trouble is that this argument was never presented to the District Court and there is no real reason to suppose that it formed the unexpressed rationale for its decision. Moreover, this Court has never held that Rule 23(d) is an express exception to 28 U.S.C. §2283, and we cannot accept that theory today. As stated in *Mitchum v. Foster,* 407 U.S. 225, 238, 92 S.Ct. 2151, 2160, 32 L.Ed.2d 705 (1972), "The test . . . is whether an act of Congress, clearly creating a federal right or remedy enforceable in a federal court of equity, could be given its intended scope only by the stay of a state court proceeding." Rule 23(d) is a rule of procedure and it creates neither a right nor a remedy enforceable in a federal court of equity. Thus, even under the

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[27]We do not consider the "protect or effectuate its judgments" exception for the simple reason that there was no judgment to protect when the injunction issued. *See Mitchum v. Foster,* 407 U.S. 225, 236 & n. 21, 92 S.Ct. 2151, 32 L.Ed.2d 705 (1972); *International Ass'n of Machinists & Aerospace Workers v. Nix,* 5 Cir. 1975, 512 F.2d 125, 129-33 (recognizing the federal court under this exception may enjoin "the relitigation in state court of issues that federal courts have fully and finally adjudicated").

expansive *Mitchum* test, which may not be quite as expansive as it seems,[28] this argument must fail.

Next, the plaintiffs claim that the injunction was authorized by 42 U.S.C. §1983, which the Supreme Court held in *Mitchum* to be one of the "expressly authorized" exceptions to §2283. Section 1983 speaks in terms of "the deprivation of any rights, privileges, or immunities secured by the Constitution and laws," and if it were construed to mean *all* federal laws, then the exception would quickly swallow the rule set forth in §2283. *Cf. Chapman v. Houston Welfare Rights Organization,* 441 U.S. 600, 99 S.Ct. 1905, 60 L.Ed.2d 508 (1979) (Powell, J., concurring, asserting that the word "laws" in §1983 should be interpreted to mean laws providing for equal rights). This was not the result intended by the Supreme Court in *Mitchum,* as is evidenced by its direct progeny, *e.g., Juidice v. Vail,* 430 U.S. 327, 97 S.Ct. 1211, 51 L.Ed.2d 376 (1977); *Huffman v. Pursue, Ltd.,* 420 U.S. 592, 95 S.Ct. 1200, 43 L.Ed.2d 482 (1975); as well as the case of *Vendo Co. v. Lektro-Vend Corp.,* 433 U.S. 623, 97 S.Ct. 2881, 53 L.Ed.2d 1009 (1977).

[19] In this case the plaintiffs allege that they have been deprived of two separate constitutional rights. First, they argue that they were somehow deprived of property without due process of law because they never received notice of the California proceedings. Those proceedings were instituted by the California attorney

[28] *See, e. g., Judice v. Vail,* 430 U.S. 327, 341-47, 97 S.Ct. 1211, 51 L.Ed.2d 376 (1977) (Brennan, J., dissenting); *Huffman v. Pursue, Ltd.,* 420 U.S. 592, 613-18, 95 S.Ct. 1200, 43 L.Ed.2d 482 (1975).

general on behalf of California residents against a California corporation alleging violations of California law. As to themselves, non-Califonians were not bound by that judgment, and it cannot be thought that the Constitution required the attorney general to notify residents of other states of the institution of his lawsuit. The fact that Californians ultimately won a judgment against Bestline and began to recover has not deprived the plaintiff class of property without notice.

Second, the plaintiffs argue that they have been denied the equal protection of the laws because the California restitution fund denied participation solely on the basis of residence. This argument is meritless, if not frivolous. In the first place, the Modified Judgment allows anyone with a judgment to participate in the restitution fund, and it does not differentiate on the basis of residence. Next, even if the judgment allowed no persons outside California to participate, which it does not, there is no showing that this involved suspect classes, or fundamental interests or that it would be an arbitrary or irrational distinction; hence there could be no equal protection violation.

Although the plaintiffs have not articulated their arguments well, they could be advancing an assertion that Section 27 of the Securities Exchange Act, 15 U.S.C., Section 78aa, when coupled with the authority to issue injunctions and writs of mandamus contained in Section 21 of the Act, 15 U.S.C., Section 78u, constitutes an "expressly authorized" exception to Section 2283. The Second Circuit rejected a similar contention in *International Controls Corporation v. Vesco,* 490 F.2d 1334, 1349 (2d Cir., 1974); and we think

that decision, at least insofar as it affects private lawsuits, compare *SEC v. Wencke,* 577 F.2d 619 (9th Cir., 1978), is eminently correct.

[20] There can be no doubt of this conclusion after the decision of the Supreme Court in *Vendo Co. v. Lektro-Vend Corp.,* 433 U.S. 623, 97 S.Ct. 2881, 53 L.Ed.2d 1009 (1977). In that case, three Justices concluded that §16 of the Clayton Act, 15 U.S.C. §26, did not constitute an express exception to the Anti-Injunction Act. Those three Justices concluded that the *Mitchum* decision, which held that 42 U.S.C. §1983 was an express exception to the Anti-Injunction Act, was based upon a "recognition that one of the clear congressional concerns underlying the enactment of §1983 was the possibility that state courts, as well as other branches of state government, might be used as instruments to deny citizens their rights under the Federal Constitution." 433 U.S. at 633, 97 S.Ct. at 2888. They were unable to find such concerns in either the clear language or the legislative history of the antitrust laws and therefore concluded that §16 of the Clayton Act was not such an exception. Two concurring Justices would have held "that no injunction may issue against currently pending state-court proceedings unless those proceedings are themselves part of a 'pattern of baseless, repetitive claims' that are being used as an anticompetitive device, all the traditional prerequisites for equitable relief are satisfied, and the only way to give the antitrust laws their intended scope is by staying the state proceedings." 433 U.S. at 644, 97 S.Ct. at 2894 (Blackmun, J., concurring). We are unable to find any Congressional concern in the language of the Securities Exchange Act that state courts might be used to deny

individuals their rights under the Act, nor have we been pointed to any convincing legislative history to that effect. Nor can we ascertain any manner in which state court proceedings could be used to defeat the goals of the Securities Exchange Act. The California litigation was based upon violations of the state's deceptive advertising and unfair competition laws, which arguably are congruent in purpose with the Exchange Act and most assuredly do not defeat the purposes of that Act. Finally, the fact that 15 U.S.C. §78u is concerned entirely with the authority of the SEC to seek injunctions or other equitable relief strongly militates against any contention that it expressly authorizes a federal court to enjoin state court proceedings at the behest of private parties. Therefore, we conclude that for private lawsuits the Securities Exchange Act does not constitute an "expressly authorized" exception to 28 U.S.C. §2283. *See Vendo Co., supra,* 433 U.S. at 635-39 & n. 7, 97 S.Ct. 2881.

B. *The "in aid of its jurisdiction" exception*

The last argument advanced by the plaintiffs is that the District Court acted to protect its exclusive jurisdiction to adjudicate controversies arising under the Securities Exchange Act of 1934. *See* 15 U.S.C. §78aa. In *Carter v. Ogden Corp.*, 524 F.2d 74 (5th Cir. 1975), we considered and rejected a similar claim. In that case, Carter filed a suit in a Louisiana federal court alleging antitrust violations and a state law breach of contract claim. Ogden then filed suit in Delaware state court, and the Louisiana federal court enjoined Ogden from prosecuting any other suit. We reversed, noting that "[t]he phrase 'where necessary in aid of its

jurisdiction,' . . . should be interpreted narrrowly, in the direction of federal non-interference with orderly state proceedings." 524 F.2d at 76, *quoting T. Smith & Sons, Inc. v. Williams*, 275 F.2d 397, 407 (5th Cir. 1960). Finding no evidence that the Delaware proceedings would interfere with the jurisdiction of the Louisiana court to hear the case, we held that the grant of exclusive jurisdiction to federal courts to entertain antitrust actions had no impact on state law breach of contract claims.

In this case the plaintiffs have alleged violations of state law, the Securities Act of 1933, and the Securities Exchange Act of 1934. The federal courts have jurisdiction to entertain the state law claims only if diversity of citizenship is present or under the doctrine of pendent jurisdiction. The state and federal courts have concurrent jurisdiction to decide cases arising under the Securities Act of 1933, and no case originally brought in a state court of competent jurisdiction under that Act may be removed to a federal court. 15 U.S.C. §77v. Under the Securities Exchange Act of 1934, the federal district courts have exclusive jurisdiction to decide cases arising under that act. 16 U.S.C. §78aa. Thus, in this case, the plaintiffs' argument seems to include the proposition that if they are correct in their assertion that the "in aid of its jurisdiction" exception applies because of the Exchange Act, then the District Court may enjoin state court prosecutions of either state law claims or of Securities Act claims, simply because such claims have been attached to a complaint alleging violations of the Exchange Act.

[21] The California litigation was based solely upon violations of state law, and it never purported to

adjudicate a claim under the Exchange Act. Those proceedings in no way affected the "flexibility and authority" of the federal court to decide the Exchange Act claims. *See Atlantic Coast Line R. Co., supra,* 398 U.S. at 295, 90 S.Ct. 1739. The fact that Bestline might have fewer assets available to satisfy any judgment entered as a result of the Florida federal litigation in no way affects the jurisdiction of the federal court. Just as we rejected in *Williams, supra,* the claim that a federal district court may enjoin state court proceedings simply because it has before it a case arising under the antitrust laws, we reject the argument that a federal court may enjoin state proceedings in order to decide a private lawsuit brought under the Securities Exchange Act of 1934.

SUMMARY

We summarize our holdings in this case, as follows:

1. Summary judgment should not have been entered.

2. Sylva was entitled to intervention as a matter of right.

3. The attorneys' fees as proposed in the Bestline settlement should not have been approved as presented.

4. The entry of an injunction against enforcement of the judgment of the California Superior Court is reversed.

5. The order entering final judgment as to Bestline and 97 individual defendants is vacated.

CONCLUSION

The Judgment of the District Court is reversed. The case is remanded for further proceedings not inconsistent herewith.

REVERSED and REMANDED.

APPENDIX

Chronology of Events in Bestline Litigation

July 22, 1970	FTC issues complaint against Bestline.
May 12, 1971	California files suit Bestline.
Nov.3, 1971	Consent order with FTC becomes final.
Oct. 25, 1972	Trial begins in Cal. Superior Court
June 13, 1973	Trial ends.
July 20, 1973	Piambino plaintiffs file class action in So. Dist. Florida.
July 23, 1973	Bestline files bankruptcy petition in N.D. California.
July 25, 1973	Cal. Superior Court issues written judgment and order, later stayed by N.D. California.
Dec. 21, 1973	Modified Judgment entered and Bestline withdraws bankruptcy petition.
Jan. 31, 1974	First payment made from restitution fund ($1,000,000).
May 3, 1974	Multidistrict panel first transfers cases to S.D. Florida.
June 30, 1974	Second payment made from restitution fund ($1,000,000).
Sept. 20, 1974	Lead counsel threaten Bank of America.
Oct. 8, 1974	Lead counsel threaten Bank of America.
Nov. 14, 1974	Cal. Superior Court orders payments to be made.
Nov. 15, 1974	Lead counsel file class action in N.D. California to enjoin payments.
Nov. 22, 1974	S.D. Florida certifies class.

Dec. 20, 1974	Multidistrict panel conditionally transfers N.D. California suit to S.D. Florida.
Jan. 1, 1975	Third payment made from restitution fund ($1,000,000).
Feb. 14, 1975	Multidistrict panel vacates previous order. Case returns to N.D. California.
March 28, 1975	Hearing held in N.D. California; plaintiffs fail to appear.
April 4, 1975	N.D. California dismisses complaint with prejudice.
June 30, 1975	Fourth payment made from restitution fund ($1,000,000).
Jan. 1, 1976	Fifth payment made from restitution fund ($250,000).
Feb. 23, 1976	Ninth Circuit dismisses appeal.
March 19, 1976	S.D. Florida grants motion for summary judgment.
April 2, 1976	N.D. California holds that Bestline has violated consent order.
June 30, 1976	S.D. Florida enjoins Bestline from bench; written order follows on July 7.

APPENDIX F

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

October Term, 19

No. 76-3495

D. C. Docket No. CA 73-1230-JLK

PETER PIAMBINO, ET AL.,
Plaintiffs-Appellees,

versus

WILLIAM E. BAILEY, ET AL.,
Defendants,

BESTLINE PRODUCTS, INC., a
California Corporation, ET AL.,
Defendants-Appellants.

Appeal from the United States District Court for the
Southern District of Florida

Before COLEMAN, Chief Judge, GOLDBERG and
RUBIN, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Florida, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the order of the District Court appealed from, in this cause be, and the same is hereby, reversed; and that this cause be, and the same is hereby remanded to the said District Court for further proceedings not inconsistent with the opinion of this Court;

It is further ordered that plaintiffs-appellees pay to defendants-appellants, the costs on appeal to be taxed by the Clerk of this Court.

February 6, 1980

Issued as Mandate: Jun 13 1980
Reissued as Mandate: —